THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL I.S.P. (N) I. Tax—1

INTERMEDIATE COURSE (N)
ELEMENTS OF INCOME TAX-LAW
STUDY—I

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Prescribed Reading : *Sukumar Bhattacharya's Indian Income-tax Law & Practice* : Chapters I, III & IV

Introduction : In the scheme of our national economy, direct taxes occupy a very important place. Taxation is not merely considered a mere tool to raise revenue but the government is effectively utilising it as a lever to direct the flow of our scarce resources in the desired channels of investments. A chartered accountant is vitally concerned with the subject of taxation. At the intermediate stage students are expected to possess reasonable working knowledge of the *basic* provisions of Income-tax Act. The following books should serve the students' needs in this regard.

1. Indian Income-Tax Law & Practice—By Sukumar Bhattacharya.
2. Income-Tax Law and Accounts—By Dr H.C. Mehrotra.
3. The Law and Practice of Income-Tax—By Dinkar Pagare.
4. Student's Guide to Income—Tax By—Dr. Vinod K. Singhania.

Students should realise that our Study Papers are only supplementary to the text books, and, therefore, in addition to the Study Papers, they should also go through carefully the text books as well as the bare Act and Rules as amended up to date. They should also keep track of the important judgments delivered from time to time by the various High Courts as well as the Supreme Court, as reported in the Income-Tax Reports and other such journals. They should also try to understand the rationale of those decisions.

The subject-matter of our study will be covered in six study papers, as follows :

Study I=Introduction and Definitions
II=Charge of Income-tax
III=Total Exemptions
IV=Income from Salaries. Interest on Securities and Income from House Property
V=Profits and Gains of Business or Profession
VI Part A=Capital Gains, Income from other Sources and Set off of Losses Part B=Computation of the Total Income

II. Scope and Application of the Income-tax Act : The levy of income-tax in India is governed by the Income-tax Act, 1961 (hereinafter referred to as the 'Act'). This Act came into force on the Ist day of April, 1962, and extends to the whole of India (Section 1).

Rates : Income-tax is to be charged at the rate or rates fixed for the year by the annual Finance Act. If on the Ist day of April in the year the new Finance Bill has not yet been placed on the statute book, the provisions in force in the preceding year or the provisions as proposed in the Bill, then before the Parliament, whichever are more favourable to the assessee, shall apply until the new provisions become effective. (Section 4)

Definitions (Section 2) : The definitions of the various terms and expressions used in the Act are set out in Section 2 of the Act. A thorough understanding of these definition is a *slne qua non* for the proper understanding and appreciation of the various provisions of the Act. Some of these definitions have been explained in this Study Paper, while the remaining definitions have been dealt with in the subsequent Study Papers in the course of discussion under the relevant topics.

Agricultural Income : [Section 2 (1)] : *Exempted but includible for rate purposes* : Section 10 (1) provides that agricultural income is not to be included in the total income of the assessee. The reason for totally exempting agricultural income from the scope of Central income tax is that the Parliament has no power under the Constitution to levy tax on agricultural income; only the State Governments have the power to tax agricultural income.

However, the Finance Act of 1973 has introduced a special provision providing for aggregation of both agricultural and non agricultural components of income of certian non-corporate assessees (individuals, Hindu undivided families, unregistered firms, association of persons, bodies of individuals and artificial juridical persons) for purposes of determining the rates of income-tax that will apply to the non-agricultural portion. This provision is applicable only when the assessee's net agricultural income exceeds Rs. 600 and non-agricultural income exceeds Rs. 15,000.

Definition : The definition of agricultural income is indeed very wide. It covers the income of not only the cultivators but also the landholders. Agricultural income may be realised in cash or kind. It may be broadly classified as follows :

A. Agricultural rent or revenue—Section 2(1)(a) ;

B. Income from agricultural produce and from the processing of the produce to make it marketable—Section 2(1)(b) ;

C. Income from buildings—Section 2(1)(c).

A. **Agricultural rent or revenue** : In order that such rent or revenue may constitute agricultural income all the following conditions should be satisfied :

(*i*) the rent or revenue should be derived from land ;

(*ii*) the land should be situated in India ; and

(*iii*) the land should be used for agricultural purposes.

Income derived from land situated in India, whether or not assessed to land revenue or any local rate, and used for agricultural purposes will be treated as agricultural income. It may be noted that the two conditions, *viz.*, that the land should be situated in India and that it should be actually used for agricultural purposes, must be satisfied in every case irrespective of the fact whether the exemption as agricultural in come is sought under Section 2(1)(a) or (2)(1)(b) or 2(1)(c). Activities,

not involving any basic operation like tilling of the land, sowing or dissemination of seeds and planting on the land would not constitute agriculture merely because they have relation to or connection with the land. For instance, breeding and rearing of livestock, dairy farming and poultry farming wouid not by themselves be agricultural purposes. (*State of Orissa v. Ram Chandra Choudary 46*) (*ITR 246*). If agricultural lands are situated in a foreign State, the entire income would be taxable. As for the land in India, unless there is some measure of cultivation of the land, some expenditure of skill and labour upon it, it cannot be said to be used for agricultural purposes.

B. **Income from agricultural produce and from marketing process** : Agricultural income may also be resulting in any income derived from such land (land which is situated in India and is used for agricultural purposes) by :—

(*i*) agriculture ; or

(*ii*) the performance of any process ordinarily employed by a cultivator or the receiver of rent-in-kind to render the produce raised by him fit to be taken to the market ; or

(*iii*) the sale of the produce raised or received by a cultivator or receiver of rent-in-kind in respect of which no process (other than the one specified in (*ii*) above) has been performed.

The process to which the agricultural produce is subjected to should be one which is ordinarily employed by a cultivator ; it is immaterial whether the process is manual or whether it involves the use of machinery. However such a process must be employed to render the produce fit to be taken to the market. The produce must retain its original character in spite of the processiag unless there is no market for selling it in that condition.

In cases where the agricultural produce like tea, cotton, tobacco, sugarcane, etc, is subjected to a manufacturing process and the manufactured product is sold, the profits on sales would have to be apportioned. The profit element referable to the manufacturing process would be taxable as business profit while the balance, referable to agricultural activities, would be agricultural income and hence exempt from tax. Rules 7 and 8 of the Income-tax Rules, 1962 provide the basis for such apportionment. Rule 7 provides that in the case of income which is partially agricultural income and partially from business chargeable to income-tax, in determining that part which is chargeable to income-tax, the market value of the agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been used as raw material in the business or the sale proceeds of which are included in the accounts of the business is deductible from the business profits as representing agricultural income. Rule 8 applies only in cases where the assessee himself grows tea leaves and manufactures tea in India. In such cases 40% of the profits on sale is taxable as business income, while the balance is exempt as representing agricultural income,

C. Income from farm building : Income from any farm building which atisfies the following conditions would be agricultural income and would consequently be exempt from tax :

(*a*) the building should be on or in the immediate vicinity of the agricultural land, *i.e.*, land which is situated in India and is used for agricultural purposes ;

(*b*) it should be owned and occupied by the receiver of the rent or revenue of any such land or occupied by the cultivator or the receiver of rent-in-kind of any land with respect to which, or the produce of which, the process mentioned in B (ii) or (iii) stated above is carried on :

(*c*) the receiver of the rent or revenue or the cultivator or the reciver of rent-in-kind should, by reason of his connection with land, require it as a dwelling house or as a store or other out-building.

In addition to the above three conditions, any one of the following two conditions should also be fulfilled :

(1) the land should either be assessed to land revenue in India or subject to a local rate assessed and collected by the officers of the Government as such ; or

(2) where the land is not so assessed to land revenue in India or subject to a local rate ;

(*i*) it should not be situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board and which has a population of not less than ten thousand ; or

(*ii*) it should not be situated in any area within such distance, not being more than eight kilometres, from the local limits of such municipality or cantonment board, as the Central Government may by notification in the Official Gazette, specify in this behalf.

Having considered the three broad categories of agricultural income, let us now proceed to see some other related aspects of the problem. Agricultural income is exempt, howsoever and by whomsoever it is received. However, non-agricultural income does not become agricultural merely on account of its indirect connection with the land. For instance, remuneration for managing an agricultural estate or collecting revenue in respect thereof would not constitute agricultural income.

Some Specific Cases:

A. Income from Sale of Trees of Spontaneons Growth :

In *C.I.T v. Jyotikana Chowdhayani and Others* [*32 ITR 705* (*S C*)] the Supreme

Court held that the operations undertaken in the maintenance of forest trees of spontaneous growth such as preservation of blocks of forest and their operation by rotation, marking of trees for felling, creeper and climber cutting, thinning and removal of diseased and unsound trees, cleaning of jungles and under growths, preservation of mother trees etc., shall not be treated as basic operation of agriculture. Further, the operations in forestry were performed after the produce had sprouted from the soil. And no human skill and labour was spent on the cultivation of the forest land ; nor were any operations performed on the land itself. Not even one of those operations was assimilated to the basic operations in agriculture. Hence the income derived from the sale of trees of spontaneous growth was, therefore, not agricultural income u/s 2(1).

B. Interest on Arrears of Rent on Agricultural Land :

The Privy Council held in *C.I.T v. Raja Bahadur Kamakshaya Narayan Singh & Others 16 ITR 325)* that interest on arrears of rent payable in respect of land used for agricultural purposes is not agricultural income and is not therefore exempt from income-tax. It is based on the argument that interest payable (whether by statute on not) on arrears of rent which have already become a debt due is not referable in any way to the relationship of landlord and tenant, but it is attributable solely to their character as creditor and debtor. It is also stated that such interest is not a part of the rent nor is it an accretion to it though it is received in respect of it. Hence the interest on arrears of rent on agricultural land does not constitute agricultural income.

C. Dividends Received from a Company Involved in Agriculture :

It was held in *Mrs. Bacha F. Guzdar v. C.I.T.* [*27 ITR 1 (S.C.)*] by the Supreme Court that agricultural income as defined in the Act is intended to refer to the revenue received by direct association with the land which is used for agricultural purposes not by indirectly extending it to cases where that revenue or part thereof changes hands either by way of distribution of dividends or otherwise. In fact dividend is derived from the investment made in the shares of the company and its foundation rests on the contractual relations between company and the shareholders. It is the direct and immediate source that is relevant but not indirect, remote and ultimate relation for the purpose of determining the source of income. Hence the dividends received from a company involved in agriculture shall not be treated as agricultural income.

D. Life Annuity Charged on the Agricultural Land as a Consideration for the Transfer of such Land :

In Maharajkumar Gopal Saran Narain Singh v. C.I.T. [*3 ITR 237 (P.C.)*], where the assessee sold his agricultural land for *inter alia* a life annuity, it was held that such annual payment was not agricultural income as it was not rent or revenue derived from land but money payable under a contract imposing personal liability on the covenant or the discharge of which was secored by a charge on land. And

this was also clearly a case where the owner of an estate had exchanged a capital as set for *inter alia*, a life annuity which was income in his hands and not a case in which he had exchanged his estate for a capital sum payable in instalments. Hence the life annuity in exchange of agricultural land was a revenue receipt of non-agricultural nature.

E. Salary Received by a Partner from the Firm :

The Supreme Court held in *C.I.T. v. Chidambaram Pillai (1977)* 106 I.T.R. 292, that the salary received by a partner from the firm in which he is such partner cannot be regarded in any way as having a source different from that of his share in the profit of the firm he received. Such salary is only a mode of adjustment in his share of income of the firm and continues to bear for purpose of charge at his hands, the same character as a part of the total income of the firm which has to be shared between the partners. In this view of the matter, the Court held that where a partner received salary from a firm which derived profits from cultivation, manufacture and sale of tea, under Rule 8 of the Income tax Rules, only 40% thereof would be chargeable to tax and the balance being agricultural income would be exempt.

The following items of income shall be considered agricultural income within the meaning assigned to it under Section 2(1) :

(1) Compensation received from an insurance company for damage caused by hail storm to a standing crop or garden.
[*CIT v. B. Gupta (Tea) P. Ltd. (1969) 74 ITR 337 (Cal)*]

(2) Where the denuded parts of the forest were replanted and subsequent operations in forestry were carried out, the income from the sale of such replanted trees was held to be agricultural income.
[*CIT v. Benoy Kumar Sahas Roy (1957) 32 ITR 466 (SC)*]

(3) Fees collected from owners of cattle normally used for agricultural purposes for allowing them to graze on forest lands covered by jungle and grass grown spontaneously.
[*CIT v. R.B. Rai Shamsharjang Bhadur (1953) 24 ITR 1 (All)*]

(4) Compensation received for being kept out of cultivation of agricultural land.
[*CIT v. Gouri Shankar Agarwal (1980) 19 CTR (All) 322*]

(5) Interest on capital received by a partner from the firm engaged in agricultural operations.
[*CIT v. M.L. Mahindra (1978) 112 ITR 323 (Gau)*]

(6) Profit made on sale of standing crop or the produce after harvest by cultivating owner or tenant of land.
[*CIT v. Maddi Venkata Subhayya (1951) 20 ITR 151 Mad)*]

The following items of income shall not be treated as agricultural income within the meaning assigned to it under Sec. 2(i):

1. Rent of the site of a flour mill ;
Conville v. CIT 4 ITR 137

2. Income derived from land used for potteries or as brick fields ;
Prabhat Chandra Barua v. C.I.T. 5 ITC 1 (P.C.) and *Janki Kuer v. CIT 5 ITC 42*

3. Income derived from land used as stone quarries ;
Shib Lal Ganga Ram v. C.I.T. 2 ITC 425

4. Income from land let out for storing crops or stacking timber ;
Prabhat Chandra Barua v. CIT 5 ITC 1 (P.C.)

5. Compensation for acquisition of land for military purposes ;
Pydah Suryanaryana Murthy v. CIT 42 ITR 83

6. Income from fisheries ;
CIT v. Sevuga Thevar 1 ITR 78

7. Income from ferries and moorings ;
Maharaja of Darbhanga v. CIT 1 ITC 303

8. Income derived from letting land and trees for cultivation of lac ;
Beohar Singh v. CIT 16 ITR 433,444

9. Profits of salt produced by flooding the land with sea water ;
Linga Reddy v. CIT 2 ITC 363.

10. Profit accruing from the purchase of a standing crop and resale of it after harvest by a merchant having no interest in land except a mere licence to enter upon the land and gather the produce, since land is not the direct, immediate or effective source of income :
CIT v. Maddi Venkatasubbayya (1951) 20 ITR 151 (Mad)

11. Remuneration received by managing agent at a fixed percentage of net Profit from a company having agricultural income ;
Premier Construction Co. Ltd. v. CIT (1948) 16 ITR 380 (PC).

Income from Nursery is not necessarily agricultural income unless maintained by a farmer as an aid or necessary adjunct to the primary process of agriculture.
[*H.H. Maharaja Vibhuti Narain Singh v. State of U.P. 65 ITR 364(All)*]

2. Assessee (Section) 2(7) : The term 'assessee' is defined as meaning a person (as defined in clause 2(31)) by whom any tax or any other sum of money (which would include penalty or interest) is payable under the Income tax Act. It also includes every person in respect of whom any proceeding under the Act is taken for the assessment (a) of his income, (b) of his loss, or (c) of the amount of refund due to him.

Thus, two categories of persons are covered by the definition : (i) Persons by whom any tax, penalty or interest is payable under the Act, whether any proceeding under this Act has been actually taken against them or not; and (ii) persons against whom any proceedings under the Act have been taken whether or not they are liable to pay tax, penalty or interest.

The expression 'assessee' also includes any person who is assessable in respect of the income or loss of another by virtue of the provisions of Sections 60 to 65, 92 or who is deemed to be an assessee under Sections 159 and 160 or an assessee in default under Section 201.

3. **Assessment** [Section 2(8)] : The term 'assessment' means computation of tax and procedure for imposing t x liability. Section 2(8) defined 'assessee' to include reassessment.

4. **Person** [(Section 2(3)] : The definition of 'assessee' leads us to the definition of 'person' as the former is closely connected with the latter. The term person is important from another point of view also viz., the charge of income-tax is on every 'pers n'. The definition is comprehensive and it includes, (i) an individual, (ii) a Hindu undivided family, (iii) a company, (iv) a firm, (v) an association of persons or a body of individuals, whether incorporated or not, (vi) a local authority, and (vii) every artificial juridical person *e.g.*, an idol or deity. We may briefly consider some of the above seven categories of assessees each of which constitutes a separate unit of assessment.

Individual : The term 'individual' means only a natural person. i.e., a human being. It includes both males and females. It also includes a minor or a person of unsound mind. But the assessment in such a case may be made under Section 161 (1) on the guardian or trustee of the minor or lunatic. In the case of a deceased person assessment would be made on the legal representative.

Hindu undivided family : A Hindu undivided family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. The Hindu undivided family is assessed to income-tax as a distinct entity or a unit of assessment.

The expression 'Hindu undivided family' is used in the Act with refence not to one school of Hindu law but to all schools. The two priucipal schools of Hindu law are the Mitakshara and the Dayabhaga. The Dayabhaga School prevails in Bengal and the Mitakshara School prevails in the rest of India. A Hindu joint family is a wider body than Hindu coparcenary. The composition of a Hindu family is a wider body than Hindu coparcenary. The composition of a Hindu family keeps fluctuating by reason of births and deaths in the family, marriages and adoptions; coparcenary includes only those persons who acquire by birth an interest in the joint or coparcenary property, those being the sons, grandsons and great grand sons of the holder of the joint property for the time being. A coparcenary cannot commence without a common male ancestor. After his death it may consist of

collaterals, such as brothers, uncles, nephews, etc. At any particular point of time, it is limited to members within four degrees inclusive of the common male ancestor. Persons outside the degree do not belong to the coparcenary. The Hindu undivided family, on the other hand, whether governed by the Mitakshara law or the Dayabhaga law, should consist of both males and females. However, there is one distinction. In a Mitakshara family, no female, be she a wife, mother, a daughter, would be entitled to demand a partition of the corpus or income of the family, except on a statutory succession under the Hindu Succession Act, which came into force on 17th June, 1956. However, on a partition between her husband and her sons, a Mitakshara Hindu wife is entitled to a share equal to that of a son. But it is an inchoate right and she has no interest in the joint family property and she has no right to challenge the alienation of such property. Hence, unless actual partition by metes and bounds takes place, she has merely a right of maintenance and no right to claim a share and no right to get a share prior to the actual moment of partition by meets and bounds. Under the Dayabhaga law, female heirs could succeed to a member of an undivided family and would be entitled to take his share on his death and enjoy the same with absolute right in co-tenancy with the other male members.

In the Mitakshara School, the foundation of a coparcenary is first laid when a son is born to the Mitakshara father whereas under the Dayabhaga School, the foundation of a coparcenary is first laid on the death of the father leaving him surviving more than one son. In the Mitakshara School of Hindu law, a son acquires at his birth an equal interest with his father in all the ancestral property held by the father and, on his death, the son takes the property not as his heir but by survivorship. According to the Dayabhaga school, the sons do not acquire any interest at birth in ancestral property. Their rights for the first time arise on the father's death. On the death of the father, sons take such property as left by their father, whether separate or ancestral, as heirs and not by survivorship. Since the sons do not take any interest in the ancestral property in their father's life time, there can be no coparcenary in the strict sense of the word between a father and the sons, according to the Dayabhaga law, as regards the ancestral property. Thus, there are basic differences in the incidents attached to Hindu family in the Mitakshara and the Dayabhaga Schools of Hindu law.

There need not necessarily be more than one male member to form a Hindu undivided family along with female members. When a caparcener, having a wife and a minor daughter and no son receives his share of joint family properties on partition, such property in the hands of coparcener belongs to the Hindu undivided family consisting of himself, his wife and minor daugher and the income from such property would be assessed in the hands of the Hindu undivided family. A joint Hindu family may be composed of a number of smaller or branch joint families which may hold properties in their own right and may themselves be assessable units distinct from the apex joint family. A Jain undivided family would also be assessed as a Hindu undivided family, as Jains are also governed by the laws as Hindus.

Association of Persons (AOP) : When persons combine together for promotion of a joint enterprise they are assessable as an 'association of persons' when they do not in law constitute a partnership. In order to constitute an association, persons must join in a common purpose, common action and the object of the association must be to produce income ; it is not enough that the persons receive the income jointly. Co-heirs, co-legatees or co-donees joining together in a common purpose or actions would be chargeable as an association of persons. In the case of an association of persons, the Income-tax Officer has the option, which must be judicially exercised to assess the tax either on the association itself as a unit of assessment or on the members of the association as individuals in respect of their respective shares of the profits made by the association. Once the Income-tax Officer has made assessments of the members individually, he cannot thereafter assess the same income in the hands of the association. A member of an association is not liable to pay tax again in respect of his share in the profits of the association on which tax has already been paid by the association.

Body of Individuals (BOI) : The expression 'body of individuals' denotes the status of persons like executors or trustees who merely receive the income jointly and who may be assessable in like manner and to the same extent as the beneficiaries individually. Thus co-executors or co-trustees are assessable as a body of individuals as their title and interest are indivisible. Income-tax shall not be payable by an assessee in respect of the share of income received by him from BOI and on which the tax has already been paid by such BOI.

Company : The definition and scope of the term 'company' have been discussed later in this Study Paper.

Firm : The Income-tax Act recognises a 'firm' as a separate entity different and distinct from the partners. Under the Act, the terms 'firm', 'partner' and partnership' have the same meanings as assigned to them in the Indian Partnership Act. However, for income-tax purposes a minor admitted to the benefits of an existing partnership would also be treated as partner. This is specified in Section 2(23) of the Act. A partnership is the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all. The persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm'. A sub-partner cannot be regarded as a partner in the main firm. For the purpose of the Income-tax Act, firms have been classified as 'registered firms', and 'unregistered firms'. If a firm is validly constituted under an instrument of partnership specifying the individual shares of the partners and is genuine, an application may be made under Section 184 to the Income-tax Officer on behalf of such a firm for its registration under the Income-tax Act. In such cases, registration may be granted to the firm if the specified conditions are satisfied. A firm which is not registered is known as 'unregistered firm'. Although registration under the Act is not compulsory for partnership firms, the question of registration is a material factor in assessing firms. An unregistered firm is charged as a unit of assessment ; while in the case of a registered firm although

tax (known as firm's tax) at specially low rates is levied on the firm, the substantive levy is on each individual partner in respect of his share of the firm's profits. In cases where it would be more beneficial to the Revenue even an unregistered firm can be assessed as a registered firm regardless of the fact whether the firm is entitled for registration or not. The assessment of firms is governed by the provisions of Sections 182 to 189.

Local Authority: The term 'local authority' means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund. In this context, it may be noted that a local authority is taxable in respect of that part of its income which arises from any business carried on by it in so far as that income does not arise from the supply of a commodity or service within its own jurisdictional area. However, for and from the assessment year 1972-73 income arising from the supply of water and electricity even outside the local authority's own jurisdictional areas is exempt from tax.

Artificial Juridical Person: This category would cover every artificial juridical person not falling under other heads. It is intended primarily to refer to private religious trusts. An idol or deity would be assessable in the status of an artificial juridical person.

Charitable Purposes: Section 2(15) states that 'charitable purpose' includes relief of the poor, education, medical relief and the advancement of any other object of general public utility. Sec. 10(21) totally exempts the income of an approved scientific research association which is applied solely to the purposes of that association. Section 10(22A) exempts any income of hospitals and other medical institutions not existing for profit. Section 10(22) exempts any income of a university or other educational institution, existing solely for educational purposes and not for purposes of profit. An institution or trust for "the relief of the poor, education, medical relief and the advancement of any other object of general public utility", therefore means for all practical purposes in the context of Sections 11, 12, 12A and 13 a body other than a scientific research association or a hospital or an educational institution covered by clauses (21) (22A) and 22 respectively of Section 10.

The definition of "charitable purpose" includes "any other object of general public utility". The question arises as to what is an object of "general public utility". The expression has not been defined anywhere in the Act.

The Supreme Court in the case of *CIT v Andhra Chamber of Commerce* (*1956*) *55 ITR 722 (SC)* held that the advancement or promotion of trade, commerce and industry leading to economic prosperity enured for the benefit of the entire community. That prosperity would be shared also by those who were engaged in a trade, commerce and industry. But on that account the property was not rendered any thing less than an object of general public utility. So, when the principal-object of a chamber of commerce was to promote and protect trade, commerce and industry

and to aid, stimulate and promote the develepement of trade, commerce and industry in India or any part thereof, the Supreme Court held that the said object was of general public utility.

In the above-noted case the Supreme Court, while discussing the meaning of the expression "charitable purpose" observed as follows :

"Charitable Purpose" includes not only relief of the poor, education and medical relief alone, but advancement of other objects of general public utility as well. Section 2 (15) is intended to serve as a special definition of the expression "charitable purpose" for the Act. It is again inclusive and not exhaustive or exclusive. Even if the object or purpose may not be regarded as charitable in its popular signification as not intended to give relief to the poor or for the advancement of education or medical relief, it should still be included in the expression 'charitable purpose' if it advances an object of general public utily. *The expression 'object of general public utility", however, is not restricted to objects beneficial to the whole of mankind. An object beneficial to a section of the public could also be treated as an object of general public utility.* To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of the community sought to be benefited must undoubtedly be sufficiently defined and identifiable by some common quality of a public or impersonal nature; where there is no common quality uniting potential beneficiaries into a class, it may not be regarded as valid.

The Bombay High Court held in *Bar Council of Maharashtra v CIT (1980) 126 ITR 27 (Bom)* that the word "general" in Section 2(15) means pertaining to a whole class, the word "public" means the body of people at large and the word "utility" means usefulness. Thus, the advancement of any object beneficial to the public or a section of the public as distinguished from an individual or group of individuals would be a charitable purpose. The State Bar Council was held to be a body constituted for general public utility whose income would been entitled to exemption under Section 11. The Supreme Court affirmed the decision of the High Court when the case came up in appeal in *CIT v Bar Council of Maharashtra (1981) 130 ITR 28 (SC).*

The Finance Act 1983 has omitted the words "not involving the carring on of any activity for profit" appearing at the end of Section 2 (15) with effect from Assessment Year 1984-85. The effect of this amendment is that a trust will be treated as a charitable trust under section 2 (15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under Section 11 on the ground that its objects are non-charitable.

6. **Company and other related terms :**

1 Company (Section 2 (17)). For all purposes of the **Income-tax** Act the term 'Company' has a much wider connotation than **that under the Companies** Act Under the Income-tax Act, the expression '**Company**' means :

(i) any Indian company as defined in Section 2 (26), or

(ii) any body corporate incorporated by or under the laws of a country outside *India, i.e., any foreign company, or*

(iii) any institution, association, or body which is or was assessable or was assessed as a company for any assessment year under the 1922 Act or for any assessment year commencing on or before 1st April 1970 under the present Act, or

(iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the Central Board of Direct Taxes to be a company for such assessment year or years as may be specified in the Board's order.

2. **Classes of Companies**

(i) **Indian Company** (Section 2 (26)): Let us now see the meaning of the expression 'Indian Company' (referred to in (i) above). Two conditions should be satisfied so that a company can be regarded as an Indian company. The company should have been formed and registered under any law relating to companies which was or is in force in any part of India, and secondly, the registered office of the company should be in India. The expression 'Indian Company', also includes a corporation established by or under a Central, State or Provincial Act (like Financial Corporation or a State Road Transport Corporation) and an institution or association or body which is declared by the Board to be a company under Section 2(17) (iv) provided its registered or principal office is in India.

Thus it becomes clear that under the Act, even an unregistered or unincorporated association may be declared to be a company and consequently what is not legal entity may be assessable as a company. Even a company registered under Section 25 of the Companies Act, without a commercial or profit motive, would be assessed as a company for income-tax purpose. A company in liquidation would be a company within the meaning of Section 2(17) for all purposes of assessment including the levy of penalty. In such cases, the liquidator would have all the obligations of a principal officer of the company. But an assessment cannot be made on a company after it has ceased to exist and has been struck off the register of companies.

(ii) Company in which public are substantially interested [Section 2 (18)] : The following companies are said to be companies in which the public are substantially interested :

1. A company owned by the Government (either Central or State but not foreign) or the Reserve Bank of India or in which not less than forty per cent of the shares are held by the Government or the Reserve Bank of India or corporation owned by that bank.

2. A company which is registered under Section 25 of the Companies Act, 1956 (formed for promoting commerce, arts, science, religion, charity or any other useful object).

3. A company having no share capital which is declared by the Board for the specified assessment year or years to be a company in which the public are substantially interested.

4. A company which is not a private company as defined in Section 3(1) (ii) of the Companies Act, 1956 and which fulfills the conditions specified in *either* of the two items (A) or (B) given below, namely :—

(A) the equity shares in the company should have as on the last day of the relevant previous year been listed in a recognised stock exchange in India ; or

(B) Equity shares in the company carrying not lees than 50 per cent (40 per cent in case of industrial companies) of voting power should have been unconditionally allotted to or acquired by and should have been throughout the relevant previous year beneficially held by (a) the Government or (b) a Statutory Corporation or (c) a company in which public are substantially interested or any wholly owned subsidiary of such company.

Therefore any company whose shares are not being listed in a recognised stock exchange shall not be treated as a company in which public are substantially interested unless its equity shares carrying not less than 50% or 40%, as the case may be, are being beneficially held throughout the relevant previous year by the Government or a Statutory Corporation or a company in which public are substantially interested or its wholly owned subsidiary company.

(*iii*) **Domestic Company** : (Section 80B (2)): The term 'domestic company' means (*i*) Indian company or (*ii*) any other company which in respect of its income liable to tax under the Act, has made the prescribed arrangements for the declaration and payment within India of the dividends (including dividends on preference shares) payable out of such income.

(*iv*) **Foreign Company** : (Section 80B(4)) : A foreign company is one which is **not a domestic company.**

(*v*) ***Industrial Company*** : This expression means a company which is mainly engaged in the business of generation and/or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining. By virtue of the amendments made by the Finance Act,1983 the term industrial company includes companies which are mainly engaged in the business of carriage, by road or inland water ways, of passengers or goods or in the business of execution of projects. The term 'project' means a project for the construction of a building, road, dam, bridge or other structure or assembly or installation of any machinery or plant For this purpose, a company shall be deemed to be mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacturing or processing of goods or in mining or carriage by road or inland waterways of passengens or goods or in the execution of projects if the income attributable to any one or more of the aforesaid activities included in its total income of the previous year (as computed before making any deduction under Chapter VI A of the Act) is not less than 50% of such total income [Section 2(7) (c) of the Finance Act, 1979].

(*vi*) **Investment Company** (Section 109(*ii*)) : The expression 'investment company' means any company whose gross total income consists mainly of income chargeable under the heads 'Interest on securities', 'Income from house property', Capital gains' and 'Income from other sources'

(*vii*) **Trading Company** : (Section 109(*iii*-a) : The expression trading company' means a company whose business consists mainly of dealing in goods or merchandise manufactured, produced or processed by a person other than that company and whose total income attributable to such business included in its gross total income is not less than 51% of the amount of such gross total income.

Person having a substantial interest in the company (Section 2(32)) : A person who is a beneficial owner of shares (not being shares entitled to a fixed rate of dividend) whether with or without a right to participate in profits carrying not less than 20% of the total voting power would be considered to be a person having a substantial interest in the company. The main criterion to be applied for this purpose is the beneficial ownership and not legal ownership. Therefore, the registered holder of even the majority of equity shares, shares would not fall within this definition if he has no beneficial interest in the shares. On the other hand, a person who is beneficially entitled to 20% or more of the equity share capital of a company would fall within this definition even if he is not the registered holder of any shares.

7. **Amalgamation** (Section 2(1A)): The term 'amalgamation' in relation to companies means the merger of one or more companies with another company to form one company or the merger of two or more companies to form one company. The company which so merges is called the amalgamating company and the company with which it has merged or which is formed as a result of the merger is called the amalgamated company. The following conditions should be satisfied if the amalgamation is to be valid and effective :

(*i*) All the *properties and liabilities* of the amalgamating company should become the property and liabilities of the amalgamated company by virtue of the amalgamation.

(*ii*) The shareholders holding not less than 90% of the value of the shares in the amalgamating company or companies must become shareholders of amalgamated company by virtue of the amalgamation. However, for this purpose, shares which were already held immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary should not be taken into account.

The definition of the term specifically makes it clear that cases where the property of one company is acquired by another company (*i*) as a result of purchase of such property by the other comyany, or (*ii*) as a result of the distribution of such property to the other company, would not constitute cases of amalgamation.

8. **Dividend.** (Section 2(22)) : The term 'dividend' as used in the Act has a wider scope and meaning than under the general law. The inclusive definition of the term given in Section 2(22) brings certain payments and distributions by a company which may not be regarded as dividend under the general law withhin the scope of the term "dividend". All the five items of dividend enumerated in Section 2(22) are cases of distribution or payment out of or to the exent of the *accumulated profits* of the company. Any receipt by a shareholder which is 'dividend' under the general law would be taxable as such under this Act, even if it is not attributable to the company's accumulated profits' within the meaning of the clause or for any other reason falls outside this definition.

'Dividend' thus includes—

(*a*) any distribution by a company of its *accumulated profits*, whether capitalised or not, which entails a release by the company to its shareholders of all or any part of its assets (Section 2(22)(a)) ;

(*b*) any distribution to its shareholders by a company of debentures, debenture stock or deposit certificate in any form, whether with or without interest, and any distribution to its *preference shareholders of shares by way of bonus* to the extent to which the company possesses *accumulated profits*, whether capitalised or not (Section 2(22)(b)) ;

(*c*) any distribution made to the shareholders of a company on its liquidation to the extent to which the distribution is attributable to the *accumulated profits* of the company immediately before its liquidation, whether capitalised or not (Section 2(22)(c)) ;

(*d*) any distribution to its shareholders by a company on the reduction of its share capital in respect of profits which arose after the end of the previous year ending next before the first day of April, 19 3 whether such *accumulated profits* have been capitalised or not (Sec 2(22)(d)).

(e) any payment by a company in which the public are not substantially interested of any sum (whether representing a part of the assets of the company or otherwise) by way of advance or loan to a shareholder being a person who has a substantial interest in the company, or payment by any such company on behalf of or for the individual benefits of any such shareholder to the extent to which the company in either case possesses accumulated profits (Section 2(22)(e)). For purposes of taxing the shareholder, the repayment of the loan or advance either within the same year or in the subsequent year is totally immaterial ;

"Dividend" however, does *not* include :

(*i*) a distribution made in accordance with item (*c*) or (*d*) above in respect of any share issued for full cash consideration where the holder of the shares is not entitled, in the event of liquidation, to participate in the surplus assets ;

(*ii*) a distribution made in accordance with item (*c*) or (*d*) above in so far as such distribution is attributable to the capitalised profit of the company representing bonus shares allotted to equity shareholder after the 31st day of March, 1964 and before the 1st day of April 1965.

(*iii*) any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;

(*iv*) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of item (*e*) above to the extent to which it is so set off

According to Explanation 1 to Section 2(22) the expression 'accumulated profits' used in the above discussion does not include capital gains arising to the company before 1-4-1946 or after 31-3-1948 and before 1-4-1956. It does not also include capital gains which are not taxable under the Act (*e.g.*, capital gains made on sale of agricultural land before 1-3-1970). As a result of this legal position any distribution made to the shareholders of a company on its liquidation out of non-taxable accumulated capital gains shall not be chargeable to tax as dividends. However, if the receipt in the hands of the shareholders can be brought within the meaning of 'dividend' under general law, it would still be taxable in spite of this provision. It is provided in Explanation 2 that the expression 'accumulated profits" would cover all profits of the company including general reserves and current profits upto the date of distribbntion or payment. In the case of distribution on liquidation, it includes all profits *upto* the date of liquidation. But any distribution out of the company's profits made *subsequent* to the date of liquidation would not amount to dividend. In cases where the liquidation of a company is the result of compulsory acquisition by the Government or a corporation owned or controlled

by the Government of its business or undertaking *the accumulated profits shall not include any profits of the company prior to three successive accounting years immediately preceding the years immediataly preceding the year of such acquistion.*

Bonus Shares : In a case where a company capitalises its accumulated profits by the issue of bonus shares to its shareholders, the allotment of bonus shares does not entail a *release* of the company's assets. For this reason, bonus shares do not constitute dividend or income at all when they are issued to equity shareholders. However, if the bonus shares are issued to holders of preference shares, they would be assessable as dividends under Section 2(22) (b). Where a company *bona fide* decides to capitalise its accumulated profits but offers its ordinary shareholders the option of accepting bonus shares or receiving in cash the nominal value of the bonus shares, the bonus shares so received would not be dividend. However, if a shareholder elects to receive cash, it would be dividend in his hands. If, on the other hand, a company utilises its accumulated profits for buying shares of another company and distributes those shares amongst its own shareholders it amounts to a distribution entailing a release of the company's assets and the shareholders would be taxable on the market value of the shares so received as their dividend income. However, bonus shares which are initially not taxable as dividends at the time of their issue would become taxable as and when they are paid off whether on winding up or on reduction of capital or otherwise.

Dividend would be taxable even if it is paid out of capital in violation of the aw or is declared without observance of the formalities required by the Company aw for declaration of dividend. To consider whether a distribution by a company 's dividend or not, the personal motive or purpose of the individual shareholders is rrelevant ; and if the distribution in law does not amount to a dividend, no tax can e attached to it whatever may have been the object underlying the distribution in hat form. Dividend need not necessarily be paid in cash ; it may be paid in noney's worth by the delivery, say, of goods or securities or shares in another ompany. In such cases the amount of dividend should be taken to be the market alue of the money's worth on the date dividend is declared.

Year of Taxability of Dividend

According to Section 8, any dividend (other than an interim dividend) declared, or distributed or paid by a company as stated above shall be deemed to be ie income of *the previous year in which it is so declared, distributed or paid.* A leclaration of dividend which is conditional and does not create an enforceable bligation to pay does not amount to a "declaration" within the Section 8 and the vidend is not taxable until the condition is fulfilled. Interim dividends shall be eemed to be the income of the accounting year in which *the amount of such dividend unconditionally made available by the* company to the shareholders who are ntitled to the same.

In the case of liability under Section 2(22)(e) the loan or other payment is table as dividend in the year in which the loan is paid to the shareholders or the

payment is made by the company on behalf of or for the benefit of the share-holders.

Some Illustrations

(1) Mr. X has 200 equity shares and 100 preference shares in ABC Co. Ltd. The Company distributed bonus shares of 50 and 25 on his equity and preference shareholdings respectively on 28th Dec. 1983. On 2nd Feb. 1984 he received 50 debentures carrying no interest from DEF Co. Ltd. in which he is an equity shareholder. He closes his books of account on 31st March of every year. Discuss the chargeability of the above receipts in Mr. X's hands under the Income-tax Act for the assessment year 1984-85.

Ans : Since Mr. X closes his books of account on 31st March, his previous year is the financial year. Hence for the assessment year 1984-85, his previous year shall be the one ended on 31st March, 1984 (1st April 1983—31st March 1984). So all the above transactions took place during the previous year relevant to the assessment year 1984-85.

Chargeability

(*a*) Bonus shares of 50 issued on the assessee's equity shareholding shall not be treated as Dividends u/s 2(22) (b) as the distribution of assets did not take place. But the 25 bonus shares issued to him in respect of his preference shareholding shall be deemed to be 'Dividends' but to the extent of accumulated profits possessed by the company u/s 2(22) (b).

(*b*) Debentures received by the assessee on his equity shareholding from DEF Co. Ltd. shall be taxable as 'Dividends' u/s 2(22) (b) to the extent of accumulated profits possessed by the company as on that date. It is irrelevant whether the debentures carry interest or not for this purpose.

(2) Mr. A. has 200 equity shares in XYZ Co. Ltd. The Company went into liquidation on 15th December 1983. The Company paid him Rs. 10,000 by realisation of cash after the disposal of its assets and meeting all liabilities. Out of the total surplus made by the company, 50% was attributable to accumulated profits. Assess the tax liability of Mr. X as dividends under the Income-tax Act.

Ans : As per Section 2(22) (c), dividend includes any distribution made to the shareholder by a company on liquidation subject to the limit of accumulated profits. In the present case the company on its liquidation has made a distribution of Rs. 10,000 to its equity shareholder Mr. A. out of that amount, only 50% was attributable to accumulated profits. Hence Rs. 5,000 will be treated as dividends in the hands of Mr. A.

(3) Mr. P holds equity shares carrying 30% of voting power in X Co. Pvt. Ltd. Its main business is the manutacture of stainless steel utensils. On 3rd March, 1984. Mr. P took a loan of Rs. 2 lakhs. On the above date the company had an accumulated profit of Rs. 1 lakh. Mr. P has repaid the entire loan on 30th Sept. 1984. Discuss whether there is any taxable income in the above transaction in the hands of Mr. P under the Income-tax Act, 1961 and if so what is taxable amount?

Ans. X Co. Pvt. Ltd. is a company in which the public are not substantially interested. Mr. P is a person having substantial interest in the company u/s 2(32) as he has equity shares carrying more than 20% of the total voting power. The company's main business is not money lending as it is clearly stated in the question that it is involved in manufacturing. Mr. P borrowed a sum of Rs. 2 lakhs on 3rd March 1984. On the same day the company had accumulated profits of Rs. 1 lakh. So the loan amount of Rs. 1 lakh, taken by Mr. P (a person having substantial interest) from X Co. Pvt. Ltd. (which is a company in which the public are not substantially interested and whose main business is not lending) being equivalent of accumulated profits on the date of borrowing, shall amount to dividends in the hands of Mr. P u/s 2(22) (e). Hence Rs. 1 lakh is the amount chargeable to Income-tax as dividends in the hands of Mr. P in respect of this transaction.

(4) Mr. Pawar has got 500 equity shares of Rs. 100 each in Kelvinator Ltd. He does not maintain any books of account in respect of income from shares. Kelvinator Ltd. declared interim dividends @ 10% on 31st October 1983 and annual dividends @ 15% in its Annual General Body Meeting held on 2nd February 1984. The dividends warrants of interim dividends and annual dividends were received by Mr. Pawar on 2nd May 1984 and 13th June 1984 respectively. Indicate with reasons the amounts of dividends liable to tax in the hands of Mr. Pawar for the assessment years 1984-85 and 1985-86.

Ans. Since Mr. Pawar is not maintaining any books of account, his previous year, relevant to the assessment year 1984-85 shall be the financial year ending 31st March 1984. Annual dividends shall be liable to tax in the year in which they are declared or distributed or paid as the case may be, under Section 8 (a), whereas the interim dividends shall be liable to tax in the year in which they are made unconditionally available as per Section 8 (b). In case of the annual dividends of Rs. 7,500 declared on 2nd February 1984. Mr. Pawar shall be liable to tax in the previous year ended 31st March 1984 even though he received dividend warrants after the end of the previous onyear *i.e.*30th June 1984. Mr. Pawar shall not be liable to tax in the case of interim dividends of Rs. 5,000 for the previous year ended 31st March, 1984 as they were made available to Mr. Pawar after 31st March 1984 *i.e.* on 2nd May 1984. Hence Mr. Pawar shall be liable to tax in respect of annual dividends

of Rs. 7,500 for the assessment year 1984-85 whereas he would taxable in respect of interim dividends of Rs. 5,000 for the assessment year 1985-86.

Assessment year and previous year

Assessment Year (Section 2 (9)) : The expression 'assessment year' means the period of twelve months commencing on the 1st day of April every year.

The scheme of the Income-tax Act is to levy tax for each financial year commencing on the 1st day of April and ending on the 31st day of March immediately following, at the rates or rates prescribed in the Finance Act for the year. The tax charged on the 'total income of the previous year'. The year for which the tax is paid is called the 'assessment year or income tax year' while the year in respect of the income of which the tax is levied is called the 'previous year' or the 'accounting year'. There are four exceptions to the general rule that the income of previous year alone would be assessed in the assessment year. The exceptions relate to the assessment in the case of (*a*) shipping business of non-residents (Section 172), (*b*) persons leaving India (Section 174), (*c*) persons trying to alienate their assets with a view to avoiding tax (Section 175), and (*d*) discontinued business or profession (Section 176). Let us now see the provisions of Section 3, which defines the expression 'previous year'.

Previous year (Section 3) : The 'previous year' is generally the financial year immediately preceding the assessment year. But in a case where an assessee has made up his accounts on the basis of Hindu, Christian, Tamil, Telugu, Diwali or other calendar year or where he has made up his accounts on the basis of a twelve month period starting from any day of the year, he is given an option to have as his previous year either the immediately preceding financial year or the period ending with such year for which he has made up his accounts. The assessee must exercise this option clearly by making a statement or other conduct which expresses or implies the exercise of the option. If the assessee merely produces the books of account for a period other than financial year, it would not tantamount to the exercise of the option by the assessee.

Thus, in normal cases, the previuos year will be either the financial year immediately preceding the assessment year or, at the option of the assessee, a period of 12 moths upto which the assessee has made up his accounts ending within the financial year immediately preceding the assessment year. The recent judgment of the A.P. High Court in the case of *Addl. C.I.T. v. K. Ramachandra Rao (1980) 4 Taxman 281*, clearly shows that the choice of previous year under Sec. 3 (1) (*b*) is also available to a person in receipt of a salary income. The assessment year is thus always ahead of the previous year.

Power to Determine the previous year : The general rule, as have already seen, is that the assessee's previous year must end with or within the financial year preceding the assessment year. But in some cases, it may so happen that the

assessee's accounts are kept and made up on the basis of a commercial year which terminates a few days after the end of the financial year preceding the assessment year. In such a case, if the general rule is applied without any exception then the assessment would lag behind by a year. In order to obviate such difficulties, Section 3(1) (*c*) gives power to the Central Board of Direct Taxes or to any authority authorised by the Board in this behalf to determine *any period* as the previous year in the case of any person of business or class of persons or business. In the exercise of this power, the Board or a Commissioner of Income-tax, authorised by the Board in this behalf, may determine as the previous year a period not exceeding twelve months or even a period which does not end within the previous financial year but extends into the assessment year. For instance an accounting year ending on April 15, 1980 may have the assessment year 1980-81 if the income-tax authorities so decide.

Newly set-up business or profession : Where a business or profession or vocation has been newly set-up in the financial year preceding the assessment year, the position regarding the 'previous year' would be as under :

(*i*) If no books of account of the newly set-up business or profession have been maintained, the 'previous year' for the income arising therefrom shall be the period commencing from the date on which such basiness or profession was set-up and ending on 31st day of March; the income of the period will be charged to tax in the assessment year next following.

(*ii*) If the assessee had made up accounts upto date within the financial year immediately preceding the assessment year and if these accounts do not cover a period exceeding 12 months then at the option of the assessee his previous year would be the period commencing from the date of setting up of the business and ending with the date upto which the accounts have been made up. If this option is not exercised, then the previous year would be determined by the Central Board of Direct Taxes as explained in (*iii*) below.

(*iii*) The Central Board of Direct Taxes is authorised to determine the 'previous year' even in respect of income from a newly set-up business of profession. In such cases, the previous year determined can be period commencing from the date the business was set up and ending on any date prescribed by the Board.

(*iv*) Where the accounts are closed for the first time after a period exceeding 12 months, the Central Board of Direct Taxes may determine any period commencing on the date of setting up of the business to be the previous year. In such a case, the assessee cannot claim the option of choosing his own accounting period as his previous year.

(*v*) Where an assessee has newly set-up any business or profession in the financial year preceding the assessment year and his accounts are made up to date in the *assessment year* in respect of a period not exceeding twelve months from the date of setting up of the business then *at the option* of the assessee, he would be deemed to have no previous year for that assessment year. However, in relation to the immediately succeeding assessment year such option will have the effect as an option exercised in a case falling under (ii) above.

Thus in all cases of a newly set-up business, the first accounting year must necessarily commence on the date of the setting up business and not when it is actually commenced.

Let us consider a few illustrations so that the above points may become more clear :

(*a*) If a business is set up on 1st July 1983 and no accounts are maintained by the assessee, the previous year for the assessment year 1984-85 shall be a period of nine months ending on 31st March, 1984.

(*b*) If a business is set up on 1st July, 1983 and the accounts are made upto 30th June, 1984 the assessee may elect to have the year ended the 30th June 1984 as his 'previous year' and in that case, there will be no previous year for the assessment year 1984-85. The profits for the year ended the 30th June, 1983 shall be taken as profits of the 'previous year' relevant to the assessment year 1985-86.

(*c*) If, in the above case, the accounts are made upto 31st December, 1983 and if the assessee elects to have the year ended the 31st December taken as 'previous year' the period from the 1st June to the 31st December, 1983 would be taken as the previous year for the assessment year 1984-85.

Previous year of a partner : As far as a partner's share in the income of a firm in which he is a partner, is concerned, the previous year must necessarily be taken to be the previous year as determined for the assessment of the firm if the firm has been assessed as such. However, the previous year for his *personal* income may different. If the firm has not been assessed as such or if the assessment is made directly on the partners in respect of their share of the firm's income, without any assessment being made on the firm at all, the previous year of the partner would be the period of 12 months for which accounts have been made provided the period of 12 months ends before the commencement of the assessment year of the one as determined by the Board or on its behalf.

Different previous years : As assessee is entitled to have different previous years in respect of his different sources of income even under the same head. For instance, he may have as his previous year the 'financial year' for one business and 'Diwali year' for another business. For this purpnse, it is not necessary to have

either a separate set of account books for each source of income or even to have a separate part of the books confined to income from that source. In the case of an assessee having a head office and brance offices, each branch of the business would be considered as a separate source of income.

The important principle that is to be borne in mind in this context is that where an assessee has different previous years in respect of different sources of income the income of the various previous years from the different sources should be lumped together to arrive at the total income. Similarly, except in case where the previous year is determined by the Board or any authority authorised on its behalf all the varying previous years must necessarily end with or within the financial year immediately preceding the assessment year.

Change of previous year : Where in respect of a particular source of income or in respect of business, profession or vocation newly set up (i) once the previous year has been determined and the assessee has been assessed, or (*ii*) once the assessee has exercised his option in respect of his previous year, although no assessment may have yet been made or could have been made as a result of the option, the assessee cannot change his previous year, in respect of that source, business, profession or vocation *except* with the consent of the Income-tax Officer and upon such conditions as he may impose. Thus, for example where the Income-tax Officer accords his consent to a change of the 'previous year' he has ample power to impose the condition that the full period from the end of the 'previous year' for the preceding year's assessment to the end of the new accounting year should be taken as the previous year for the current assessment year. In such a case the first previous year after the change may comprise more than 12 months and the imposition of such a condition would be well within his powers. Before permitting any change, the I.T.O. will have to ensure that the change sought for is *bona fide* and that there is no loss to revenue.

However, the conditions which the I.T.O. can impose while permitting a change of the previous year must be valid, legal and reasonable. He cannot impose conditions which are contrary to the provisions of the Income-tax Act. The conditions should be reasonable and with a view to safeguarding the interests of the revenue. However, the fact that the terms put forward by the assessee have not been found sufficient to safeguard the interest of revenue is a good ground for refusal. The Act does not require the recording of reasons by the ITO when exercising his discretion under Section 3(4) nor does the Act require that the reasons for refusal have to be communicated to the assessee. However, the discretion of the I.T.O. under Section 3(4) is not so unfettered that the decision could not be subject to challenge by means of writ proceedings under any circumstances. In other words his decision could be challenged in a court of law.

It may be noted that there is no condition of limitation in the Section as to he point of time when the consent ought to be sought or granted. It is not neces-

sary that such consent must be obtained prior to the filing of the return or at any particular stage of proceedings or before any specific event.

For example, let us assume that an assessee follows the previous year ending an June 30th every year. He has made up his accounts upto June 30th, 1980 and been assessed in respect of his income for the assessment year 1981-82. Suppose he wants to change his previous year so as to make it end on March 31st and for this purpose he seeks the consent of the Income tax Officer for the proposed change, in the month of April, 1982. In such a case, the Income-tax Officer has power to accord sanction to the proposed change on the condition that the previous year would consist of the entire period of 21 months commencing on July 1st of the year upto which his accounts were last made upto March 31st of the year upto which his accounts are newly made up. Thus, if the accounts are newly made upto, say, 31st March, 1982 then the first previous year after the change would consist of a period of 21 months consisting of the period commencing on 1st July, 1980 and ending on 31st March, 1982. The relevant assessment year would be 1982-83. It follows from the above example that the length of a previous year need not necessarily be 12 calendar months in all cases.

It should be noted that once the length of the 'previous year' is fixed and the income of the 'previous year' is determined that income must be charged at the rates specified in the relevant Finance Act and at no other rate. Even when the Incame-tax Officer accords consent for change of the previous year, he has no power to vary the rate at which the income tax of the previous year is to be assessed. These principles emerge from the decisions of the Supreme Court in *Esthuri Aswathiah v. C.I.T. (1966) 60 I.T.R. 411 (S.C.)* and the Mysore High Court in *E.Y. Pilliah & Sons v. C.I.T. (1970) 75 I.T.R. 129.*

Previous year for cash credits, unexplained investment, money and valuable articles (Sections 68, 69, 69A to 69 D) : In the context of this discussion on 'previous year' a brief reference may be made to the provisions of Sections 68, 69, 69-A, 69-B, 69-C and 69-D.

Section 68 enacts that if a sum is found credited in the books of an assessee maintained for any *'previous year'* (which may be different from the financial year) and the assessee offers no explanation about the nature and source thereof or the explanation in the opinion of ITO is not satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that *'previous year'*. Sections 69 and 69-A, which deal with unexplained investment and unexplained money, bullion, jewellery or other valuable articles respectively provide in effect that the *financial year* (though it may be different from the accounting year) in which the investment is made or in which the assessee is found to be the owner of the money, bullion jewellery or valuable articles, should be taken as the previous year for charging such items. Similarly, Section 69 B provides that where such investment, bullion jewellery or other valuable articles are not fully disclosed and only a part of the price is recorded in the books, the excess amount is deemed to be the

assessee's income of the *financial year* and not the assessee's accounting year if it does not coincide with the financial year.

Section 69-C provides that if an assessee incurs any expenditure in any financial year and offers no satisfactory explanation about the sources of the expenditure or any part thereof, the Income-tax Officer can treat the amount of unexplained expenditure as deemed income of the assessee for such *financial year*. Section 69-D seeks to lay down that a hundi loan and interest thereon which has either been obtained or repaid otherwise than through an account payee cheque shall be treated as the income of the borrower for the *previous year* in which the amount was borrowed or repaid, as the case may be.

For proper understanding of the above provisions, the following illustration is given :

Mr. Gopal closes his books of account every year on 31st December. On investigation by the I.T.O. the following facts come to his notice.

(1) Cash credit of Rs. 40,000 as on 31.1 1982 in his accounts.

(2) Mr. Gopal was possessing cash balance of Rs. 25,000 on 21.3.1983 and was not recorded in books of accounts.

(3) Mr. Gopal bought jewellery worth Rs. 25,000 on occasion of his daughter's marriage held on 10.2.1983. For the marriage he spent Rs. 30,000.

In the case of all the above transactions Mr. Gopal could not offer proper explanation to the satisfaction to the I.T.O. Hence the ITO decided to treat Rs. 1,20,000 as Mr. Gopal's income for the previous year ended 31st December 1983 relevant to the assessment year 1984-85. You are required to look into the tenability of the I.T.O.'s action and advise Mr. Gopal in this regard.

Answer :

Since Mr. Gopal has not offered proper explanation for cash credit of Rs. 40,000, cash balance of Rs. 25,000, investment in jewellery of Rs. 25,000 and marriage's expenses of Rs. 30,000, he shall be liable to tax under Section 68, Section 69A, Section 69B and Section 69C respectively. To that extent the I.T.O.'s action is tenable. But the ITO's decision of charging the whole of Rs. 1,20,000 as the income of the previous year ended 31st December 1983 is not correct in view of the following legal position.

1. Unexplained cash credit of Rs. 40,000 made in the accounts on 31.1.83 shall be deemed to be the income of Mr. Gopal for the previous year ended 31st December 1983 relevant to the assessment year 1984-85 under Section 68.

2. Unexplained money of Rs. 25,000 possessed on 21.3.1983 shall be deemed to be the income of Mr. Gopal for the financial year erded 31st Maich 1983 relevant to the assessment year 1983-84 under Section 69A.

3. Unexplained investment of Rs. 25,000 in jewellery on the occasion of Mr Gopal's daughter's marriage held 10.2.1983 shall be deemed to be income of the assessee for the financial year ended 31st March 1983 relevant to the assessment year 1983-84 under Section 69.

4. Unexplained expenditure of Rs. 30,000 incurred on the occasion of his daughter's marriage held on 10.2.1983 shall be deemed to be the income of Mr. Gopal for the financial year ended 31st March 1983 relevant to the assessment year 1983-84 under Section 69C.

Hence, Mr. Gopal snall be liable to tax for Rs. 80,000 for the assessment year 1983-84 and for Rs. 40,000 for the assessment year 1984-85.

A brief reference to the Administrative set-up under the Act : Sections 116 to 119 of the Act deal with the various income tax authorities, both quasijudicial and executive.

There are seven income tax authorities :

(*i*) The Central Boards of Direct Taxes ;

(*ii*) Directors of Inspection ;

(*iii*) Commissioners of Income-tax, Commissioners of Income-tax (Appeals), and Additional Commissioners of Income-tax ;

(*iv*) Appellate Assistant Commissioners of Income-tax ;

(*v*) Inspecting Assistant Commissioners of Income-tax ;

(*vi*) Income-tax Officers ; and

(*vii*) Inspectors of Income-tax.

The Appellate Tribunal which is envisaged by Section 252 is not an income-tax authority but a body outside the organisational set-up

The Central Board of Direct Taxes, which is the highest executive authority under the Act, is a statutory body constituted under the Central Board of Revenue Act, 1963. Its members are appointed by the Central Government. Its powers of administration, supervision and control extend over the whole department. It has power to make rules and to issue orders, instructions and directions to all officers and persons employed in the execution of this Act. However, there are two exceptions to this power—(*i*) cannot require an Income-tax authority to make a particular assessment or dispose of a particular case in a particular manner, and (*ii*) it

cannot interfere with the discretion of the Appellate Assistant Commissioner in the exercise of the Appellate function. The Board has the powers to issue general or special circulars which are binding on the department provided they do not interfere with the rights of the rights of the Income-tax Officer to make assessment according to law.

All the Income-tax authorities except class II Income-tax Officers and the Inspectors of the Income-tax are appointed by the Central Government. Income-tax Officers of class II service and Inspectors of Income-tax are appointed by the Commissoners of Income-tax subject to the rules and orders of the Central Government.

Functions of Income tax authorities : Let us now very briefly consider the role of the various authorities. The Director of Inspection shall perform such functions of any other income-tax authority as may be assigned to them by the Board. They are generally in charge of research, vigilance, inspection, investigation, etc. The Commissioners may be appointed to head the income-tax administration of any specified area, usually a district or a State or they may be appointed as Commissoners without any territorial jurisdiction, to deal with such persons, incomes or cases or classes of persons, income or cases, as the Board may direct. They are not subordinates to the Directors of Inspection. As for the Appellate Assistant Commissioners of Income-tax, they are independent and not subordinate to any of the other anthorities except, of course, the Central Board of Direct Taxes. They are under the direct administrative control and supervision of the Board. The main function is to here appeals against the order of Income-tax Officers. The Inspecting Assistant Commissioners are directly under the control of the Commissioner and perform such functions in respect of such area of such persons or classes of persons or of such incomes or of such cases or classes of cases as the Commissioner directs.

The Income-tax Officer is the most important official in the administrative hierarchy of the Income-tax Department. As already pointed out there are two types of Income tax Officers—Class I and Class II. They are subordinate to the Director of Inspection, the Commissioner of Income tax and the Inspecting Assistant Commissioner. The Income-tax Officer is the authority who initiates the assessment, calls for returns from assessee within his jurisdiction, makes the assessment, collect- revenue and makes the refunds. Wide discretionary powers and vast powers of search and seizura of documents, books of accounts, have been conferred upon him by the Act. An appeal lies to the Appellate Assistant Commissioner against an assessment made by him and against several or his other orders and decisions.

Students may note that the provisions regarding the appointment, control, jurisdiction and powers of all the above authorities will be considered in detail at the final stage of the course.

Self-Examination Questions—I

1. The Income-tax Act, 1961 extends to
(a) the whole of India (b) the whole of India excepting Jammu and Kashmir (c) the whole of Irdia excepting Nagaland (d) the whole of India excepting Jammu & Kashmir, Nagaland and the Union Territories of Manipur and Tripura. ( )

2. The rates of income-tax are prescribed by the
(a) Income-tax Act itself (b) Finance Act passed annually (c) Central Board of Direct Taxes (d) Finance Minister. ( )

3. The term agricultural income has been defined by Section (a) 2(5), (b) 10 (1), (c) 2 (32), (d) 2 (1). ( )

4. Income from agricultural land situated outside India would not be treated as 'agricultural income' within the meaning of the Income-tax Act. This statement is (a) correct (b) wrong.

5. A person by whom any tax is payable under the Act, is known as
(a) person (b) assessee (c) tax-payer (d) resident. ( )

6. The inclusive definition of the term 'person' covers
(a) five (b) four (c) six (d) seven categories. ( )

7. The term 'individual' does not include a minor. This statement is
(a) wrong (b) correct. ( )

8. Once a family is assessed as a Hindu undivided family it would continue to be assessed so for all time to come. This statement is
(a) wrong (b) correct. ( )

9. All firms should get themselves registered under the Act. This statement is (a) correct (b) wrong. ( )

10. A firm and its partners are treated as a single unit for the purpose of taxation. This statement is (a) correct (b) wrong. ( )

11. A municipality will be assessed in the status of
(a) individual (b) association of persons (c) body of individuals (d) local authority. ( )

12. The expression 'charitable purpose' is defined by Section
(a) 2 (15), (b) 2 (17), (c) 2 (22), (d) 11. ( )

13. For the assessment year 1983-84 the words 'not involving the carrying on of any activity for profit' appearing in the definition of the term 'chari-

table purpose', qualify, (a) medichl relief (b) relief of the poor (c) education (d) advancement of any other object of public utility. ( )

14. If the purpose is relief to the poor, the achievement of that purpose can involve the carrying on of any activity for profit. The statement is (a) correct (b) wrong. ( )

15. The conditions and the extent of the exemption available to charitable trusts are specified in Sections
(a) 64, (b) 27, (c) 11 to 13, (d) 25 to 27

Self-Examination Questions—II

1. The term Company has been defined by Section
(*a*) 2 (17) (*b*) 2 (18) (*c*) 2 (26) (*d*) 12.

2. The meaning of term "Company" for income-tax purposes is
(*a*) the same as (*b*) wider than (*c*) narrower than that under the Companies Act.

3. A foreign company falls within the purview of the definition of 'Company' under the Income-tax Act. This statement is (*a*) correct (*b*) wrong. ( )

4. The Central Board of Direct Taxes has got the power to declare any (*a*) institution, association or body (*b*) firm (*c*) individual (*d*) co-operative society to be a company for income-tax purposes. ( )

5. In the case of an Indian company, the registered or prinipal office should be in. ( )
(*a*) India (*b*) Delhi (*c*) where Government directs. ( )

6. A company in which the Government holds at least.
(*a*) 60% (*b*) 51% (*c*) 40% (*d*) 30% of shares ; falls under the category of companies in which public are interested.

7. All private companies will be treated as companies in which public are not substantially interested. The statement is (*a*) correct (*b*) wrong. ( )

8. A company whose affairs were controlled by 7 persons but whose shares carrying more than 50% of the total voting power were held by 5 persons would be regarded as a company in which public.

(*a*) are (*b*) are not substantially interested. ( )

9. A foreign company may be assessed as
(*i*) an Indian company (*a*) yes (*b*) no. ( )

(*ii*) a domestic company (*a*) yes (*b*) no. ( )

10. The various classes of companies are defined in the Act as under
    (*i*) Indian Company. ( )
    (*ii*) Domestic Company. ( )
    (*iii*) Company in which the public are substantially interested ( )
    (*iv*) Investment Company ( )
    (*v*) Industrial Company ( )
    (*vi*) Trading Company ( )
    (*vii*) Foreign Company ( )

    (*a*) Section 2 (17) (*b*) 2 (6) (*c*) 2 (18) (*d*) 109 (*ii*) (*e*) 109 (*iii*) of the Income-tax Act (*f*) Section 3 of the Companies Act (*g*) Section 80 (B) (2) (*h*) Section 2 (7) (*c*) of the Finance Act, 1982 (*i*) Section 80 B (4).

11. The shares held by a person having substantial interest in a company should carry at least.

    (*a*) 25% (*b*) 20% (*c*) 35% (*d*) 50% of the total voting power ( )

12. The term 'dividend' has been defined in Section
    (*a*) 2 (15) (*b*) 2 (22) (*c*) 2 (32) (*d*) 2 (17) ( )

13. The expression 'accumulated profits'
    (*i*) includes
        (*a*) general reserves (*b*) capital gains (*c*) bank balance ( )
    (*ii*) does not include
        (*a*) profit and loss appropriation account balance (*b*) general reserves
        (*c*) non-taxable capital gains ( )

14. The term 'dividend' includes bonus shares distributed
    (*a*) equity shareholders (*b*) preference shareholders (*c*) creditors or employees of a company to the extent of accumulated profits possessed by the company. ( )

15. In the case of distribution on liquidation, the term accumulated profits would include all profit earned upto the date of

    (*a*) liquidation (*b*) distribution (*c*) liquidation order ( )

Self-Examination Questions—III

1. Assessment year will always commence on
   (*a*) Independence Day (*b*) 1st January (*c*) 1st April (*d*) 15th June of every year. ( )

2. The Income-tax Act levies tax for each financial year on the income of (*a*) the previous year (*b*) same year (*c*) period ending with 31th December (*d*) last two years. ( )

3. The financial year and the previous year of an assessee

(*a*) should be the same (*b*) need not be the same (*c*) will be same in one year and different in the next year (*d*) will never be the same. ( )

4. The power to determine 'prvious year' in centain cases is confierred on (*a*) The Finance Minister (*b*) The Chief Minister of the concerned State (*c*) The authorised representative (*d*) Central Board of Direct Taxes or any authority authorised by the Boards in this behalf. ( )

5. In the case of an assessee whose previous year ends on 30th September, 1983, the relevant assessment year would be (*a*) 1983-84 (*b*) 1982-83 (*c*) 1984-85 (*d*) there will be no assessment for that previous year. ( )

6. In the case of a new business set up on 1st July, 1982 and whose accounts are made upto 30th June, 1983 for the previous year would be the year ended on

(*a*) 31st December, 1982 (*b*) 31st March, 1983 (*c*) 30th June, 1983 (*d*) 25th Janauary 1983.

7. In the above case, for the assessment year 1984-85, the previous year would be the year ending on

(*a*) 30th June, 1983 (b) 31st December, 1982 (*c*) 31st March, 1982 (*d*) there will be no previous year for that assessment year. ( )

8. The previous year in respect of a partner's income and the previous year in respect of the firm

(*a*) should be the same (*b*) need not be the same (*c*) should not be the same. ( )

9. The statement that once a previous year has been determined it cannot be ever varied unilaterally by the assessee is ( )
(*a*) correct (*b*) wrong. ( )

10. The previous year once determined can be varied only with the consent of and subject to the conditions prescribed by the

(*a*) Income-tax Officer (*b*) Inspecting Assistant Commissioner (*c*) Commissioner of Income-tax (*d*) Finance Minister. ( )

Self-Examination Questions—IV

1. The highest executive authority under Income-tax Act is the
(*a*) Commissioner of Income tax (*b*) Central Board of Direct Taxes
(*c*) Finance Minister (*d*) Director of Inspection ( )

2. All Income tax Officers are appointed by the Commissioner of Income-tax. This statement is (*a*) wrong (*b*) correct. ( )

3. Appellate Assistant Commissioners are subordinate to the Commissioner of Income-tax. This statement is (*a*) correct (*b*) wrong. ( )

4. The authority who makes tne income-tax assessment is the

(*a*) Income tax Officer (*b*) Section Officer (*c*) Commissioner of Income-tax (*d*) District Superintendent of Police. ( )

Answers to Self-Examination Questions ;

I. 1 (a) 2 (b) 3 (d) 4 (a) 5 (*b*) 6 (d) 7 (a)
8 (a) 9 (b) 10 (b) 11 (d) 12 (a) 13 (d) 14 (a) 15 (c)

II. 1 (a) 2 (b) 3 (a) 4 (a) 5 (a) 6 (a) ; (b)
7 (a) 8 (b) 9 (*i*) (b) (*ii*) (b) 10 (i) (b), (ii) (g)
(*iii*) (c), (iv) (h) (v) (h), (vi) (e) (vii) not defined
11. (b) 12 (b) 13 (i) (a) (ii) (c) 14 (b) 15 (a)

III. 1 (c) 2 (a) 3 (b) 4 (d) 5 (c) 6 (c) 7 (a)
8 (a) 9 (b) 10 (a)

IV. 1 (b) 2 (a) 3 (b) 4 (a).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL L.S.P. (N) Tax.—2

INTERMEDIATE COURSE (N)

ELEMENTS OF INCOME-TAX LAW

STUDY—II

This Study Covers:

I. INCOME

II. CHARGE OF INCOME-TAX

III. CAPITAL AND REVENUE

IV. RESIDENCE

V. TOTAL INCOME AND ITS SCOPE

VI. INCOME DEEMED TO ACCRUE OR ARISE IN INDIA

Prescribed Readings : *Sukumar Bhattacharya's* Indian Income-tax Law and Practice. Chapters II & V.

Dr. H.C. Mehrotra's Income-tax Law and Accounts, Chapters II & III

CHARGE OF INCOME TAX

1. **Income :** Income tax, as the word implies, is a tax on income. 'Income' as the Privy Council observed in the case of *Kamakshya Narain Singh v. C.I T. (1943) 11 I T R. 513*, "is a word difficult and perhaps impossible to define. It is a word of the broadest connotation",. However, Section 2(24) of the Income-tax Act gives a statutory definition of income even though the definition is more inclusive and enumerative than being exhaustive and precise According to the definition, "income" *includes* the following items of receipts.

(i) profits and gains ;

(ii) dividends ·

(iii) the value of any benefit by way of perquisite or profit in lieu of salary taxable as part of salaries under Section 17 ;

(iv) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person having substantial interest in the company or by a relative of the director or of such person and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

(iva) the value of any benefit or perquisite, whether convertible into money or not, which is obtained by any representative assessee mentioned in clause (iii) or clause (iv) of Section 160 (1) or by any beneficiary or any amount paid by the representative assessee for the benefit of the beneficiary which the beneficiary would have ordinarily been required to pay.

(v) any compensation or other payment chargeable to tax under Section 28(ii) or any amount chargeable to tax in the hands of a trade, professional or similar association under Section 28 (iii) and the deemed profits assessable under Sections 41 and 59 of the Act;

(vi) the value of any profit or perquisite taxable as business incom under Section 28 (iv);

(vii) any capital gains chargeable to tax under Section 45 ;

(viii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with Section 4 or any surplus taken to be such profits and gains by virtue of the provisions contained in the First Schedule to the Act ;

(ix) any annuity due or the commuted value of any annuity paid under Section 280 D ;

(x) voluntary contributions received by a trust created wholly, or partly for charitable purpose or by an institution established wholly or partly for such purposes, not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution; and

(xi) any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or form, gambling or betting of any form or nature whatsoever.

The above definition simply enumerates twelve artificial categories of items and seeks specially to bring these items within the general connotation of income for purposes of taxation. The word 'income' as used in the Act connotes a periodical monetary return coming in with some sort of regularity or expected regularity from definite sources. The source need not necessarily be one which is expected to be continuously productive, but it must be one the object of which is the production of a definite return excepting, however, anything in the nature of a mere windfall Thus income is compared to the fruit of a tree or the crop of a field though such picturesque similies cannot be used to limit the true character of income. Therefore anything which can properly and reasonably be described as income is taxable under the Act unless expressly exempted.

'Income' is a more general term than profits and gains and the scope of the term 'income' is not limited by the words "profits and gains". A receipt may be taxable as income although it may not contain any element of profit and gain. The taxability of an item of income is not also effected by the fact that it was derived from the exercise of statutory powers. For purposes of tax "income" includes not only those items enumerated above but also such other items or things as the word signifies according to its natural import.

In order to be taxable as income, the receipt need not necessarily arise from any business activity, investment or outlay or any enforceable obligation to pay ; it may be even voluntary or may be attributable to some custom, or traditional obligation. This is because of the fact that the word 'income' as it is used in the Act as formidably wide and vague in its scope. It is a word of elastic import and its extent and scope are controlled and limited by the use of the words 'profits and gains'. The word 'income' is not used in the Act in the popular meaning of money received but is used in a much wider sense and connotes the assessable figures arrived at after accounting for all the legitimate deductions and exemptions.

The term "income" signifies what comes in and includes sums which though not actually realised, have become due in such a manner that the assessee could at his will and pleasure receive them for reinvestment or otherwise. In order to be taxable as income, there is no absolute rule that the receipts, giving rise to income must also be of a recurrent nature. This is because of the fact that income has an infinite variety of forms and even a single receipt may be income.

The terms 'income' and 'receipt' have different connotations and scope. Income is essentially the produce of something whereas anything, which comes in would constitute a receipt. Therefore, all receipts are not income whereas all items of income would necessarily be receipts. Since tax is to be levied only on income and not on receipts, it is essential to distinguish between the two. However, it is not correct to say that every receipt which is not a capital receipt is liable to tax. On the other hand, it is only those receipts which are of the nature of income that are assessable under the Income-tax Act. Therefore, if the receipt constitutes income, they are taxable in every case and, for this purpose, it is immaterial whether they are paid for the use of an asset or for the vesting of the property itself.

It is well settled that Income-tax Act imposes a general liability to tax upon income, but the Act does not provide that whatever is received by a person must be regarded as income liable to tax. In all cases in which a receipt is sought to be taxed as income, burden lies upon the department to prove that it is within the taxing provision. Where however a receipt is of the nature of income, the burden of proving that it is not taxable, because it falls within an exemption provided by the Act, lies upon the assessee. Where the case of the assessee is that a receipt did not fall within the taxing provision, the source of the receipt is disclosed by the assessee and there is no dispute about the truth of that disclosure, the income tax authorities are not entitled to raise an inference that the receipt is assessable to income-tax on the ground that the assessee failed to lead all the evidence in support of his contention that it is within the taxing provision.

For the purpose of being subjected to tax, income need not necessarily be a recurrent return from a definite source; in fact it may not recur at all and the source may never yield a periodic return. Even an isolated transaction or adventure may constitute "business" and the income therefrom would be taxable as business income. Likewise, even a casual and non-recurring receipt may be income although it is exempt from tax under Section 10(3) to the extent the amount of such a receipt does not in any year exceed Rs. 1,000 in the aggregate.

The taint of illegality or wrong doing associated with the income, profits and gains would be immaterial for the purpose of taxation so long as the receipt can be brought within the meaning of the word "income". Taxability of an item of income is not in any way affected by the pendency of another person's claims, to it. In other words, the receipt amounting to income is chargeable to tax although there may be a rival claim to the income and or its source and the recipient may at some point of time in future, have to surrender the income and account for what he is taxed upon. But a mere claim by a person against another who has actually received the money is not sufficient to make the income accrue to the claimant and render him liable to tax.

Income, in the context of the Income-tax Act, should always be taken to be one derived by the tax payer from another person because no one can earn income from himself. But a mere relief from expenses is not income (e g., the relief granted to an auctioneer) and would not, therefore, be chargeable to tax. In cases where the deposits received by a businessman in substance partake more of the nature of trading receipt than of security deposits, such deposits, if unreturned, would be taxable as income. But unclaimed dividends do not become income merely because the amount is credited to the Profit and Loss Account when they become timebarred. Likewise, the interest by a solicitor on moneys deposited with him by his clients would not constitute his income because he stands in fiduciary relationship to his clients. Income would be taxable irrespective of the fact whether it is received in cash or kind. In case where income is received in kind, the value of the income must be taken to be the market value of the thing received (being the equivalent of cash) as on the date of receipt of the same.

II. Charge of Income tax : Section 4 of the Income-tax Act is the charging Section which provides that :—

(i) Income-tax shall be charged at the rates prescribed for the year by the Annual Finance Act;

(ii) The charge is on every person including the assessable entities specified in Section 2(31): and

(II) The income taxed is that of the previous year and not the year of assessment (subject, however, to the four exceptions provided by Sections 172, 174, 175 and 76)

(iv) The levy of tax shall be made on the total income of the assessable entity computed in accordance with and subject to the various provisions contained in the Act.

This charging Section is the back bone of the law of income-tax in so far as it serves as the most operative provision of the Act and in its absence the other provisions of the Act cannot be enforced. The liability imposed on every preson by this Section is in respect of the tax on his total income although the tax so payable does not constitute a charge on the income upon which it is levied. The liability to tax of any assessee does not, however, depend upon assessment or on the passing of the Finance Act, but arises or springs from this charging Section alone and it arises not later than the close of the previous year even though the quantification of the amount of tax payable is postponed to the date of completion of the assessment. For the purpose of making an assessment, the law to be applied is the one in force in the relevant assessment year and not the one relating to the previous year or the accounting year.

There are three stages in the imposition of a tax and they apply equally with regard to income tax as well. *First* is the declaration of liability, *i.e.*, that part of the Statute which determines the person and the property or income in respect of which they are liable. *Second* is the assessment. Although the liability to tax does not depend upon or arise as a result of assessment, an assessment is essential because it particularises the exact sum which a person has to pay. In other words, unless assessment is made to quantify the tax liability, an assessee cannot be called upon to pay the amount due from him Last is the process of collection and recovery of tax in cases where the tax payer does not voluntarily pay tax. All these three stages are separate and distinct from one another although they are inter-dependent and inter-related

III Capital and Revenue : Since income-tax is to be levied on income and not on capital it is very essential to distinguish between capital and income particularly in view of the fact that the Act has not precisely and exhaustively defined the term "income". Although the distinction between a capital receipt and a revenue receipt is fine, it is real and most material for all purposes of income-tax. The line of demarcation between the two is very thin and might often be imperceptible in most cases. It is not possible to lay down any single test as infallible or any single criterion as decisive, final and universal in application to determine whether a particular receipt

is capital or revenue nature. However, Courts have from time to time laid dow broad principles which guide the determination of the nature of the receipt and it character for tax purposes . Although the general principles have application to a' cases, the final conclusion on the capital or revenue nature of any particular receipt is one of law and, therefore, the decision of the High Court or the Supreme Court shall be final. But in case where a particular receipt is partly of a capital and partly of revenue nature, it should be apportioned between the two and the revenue part alone is to be charged to tax. The capital or revenue nature of a receipt does not, however, depend upon the following considerations, *viz* (i) the basis of its measurement; ii) the quantum and periodic ty; (iii) the name given to the receipt by the parties: (iv) the form in which the sum is received; (v) the nature of the transactions giving rise to the receipt; (vi) the nature of the asset yielding the income; (vii) the actual receipt of the amount, its source and application; and (viii) the allowance or disallowance of the amount in the paye 's hands. Therefore, the capital or revenue nature of the receipt must be determined in every case regardless of these factors but on the basis of the broad guidelines given below :

Distinction between Capital and Revenue receipts : The following are some of the important criteria which may be applied to distinguish between capital and income receipts.

1. A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. The former is exempt from tax while the latter is taxable. Circulating capital is the capital which is turned over and in the process of being turned over yields profit or loss. Fixe capital is involved directly in the process but still remains unaffected by t process. Circulating capital or stock-in-trade is also known as trading asset and fixe capital as capital asset. A capital asset in the hands of one person may be a trading asset in the hands of another and the nature of the receipt may consequently have to be determined on the basis of the nature of the trade in the course of or in connection with which it arises. In other words the determining factor should be the nature of the trade in which the asset is employed. Thus the reimbursement of a capital outlay is capital receipt even if the total amount of receipt may exceed the cost of the outlay. Similarly compensation received for the immobilisation, sterilisation or loss, whether total or partial, of a capital asset is a capital receipt whereas compensation for injurious affection of a trading asset would be revenue receipt chargeable to tax. In cases where a capital asset is transmuted into income and the price realised on its sale takes the form of periodic payments of a revenue (e.g. annuities and annual instalment of capital), the receipt would be taxable even though it is referable to a capital asset.

2. Profits arising from the sale of a capital asset are chargeable to tax as capital gains under Section 45 whereas profits arising from the sale of a trading asset being of revenue nature are taxable as income from business under Section 28 provided that the sale is in the regular course of assessee's business or the transaction constitutes an adventure in the nature of trade. A mere enhancement in the value of a

capital asset would not become either a revenue receipt or a capital receipt. Thus profit arising from the purchase and sale of share and securities (in the hands of a non-dealer in shares), gold, silver, land, buildings, plant or machinery would constitute an accretion to capital chargeable as capital gains. Also an isolated sale of trees with roots may be treated as a capital transaction. But where the purchase and sale of mining rights, ships or wagons are carried on by an assessee in the course of his trade and in pursuance of a scheme of profit-making, the transaction would result in trading profits since the asset would constitute a trading asset.

3. Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee or are incidental to or associated with the business of the assessee would be revenue receipts chargable to tax. For example, a banker's or financier's dealings in foreign exchange or sale of shares and securities, a shipbroker's purchases of ships in his own name, the sale of passenger ships by a company carrying on business as ship builders and repairers and also operating a passenger boat service, a share broker's purchase of shares on his own account would constitute transactions entered and yielding income in the ordinary course of the assessee's business. But even these cases, receipts may be on capital account under certain circumstances. In respect of transactions which are outside the ordinary course of the assessees business the taxability of the income arising from such transactions would depend upon the fact whether or not the transactions in question is in the nature of a trade. If transactions are partly in the course of and partly outside the regular trading activity of the assessee, the income arising therefrom must be segregated and allocated between the two parts and treated accordingly for tax purposes.

4. In the case of profit arising from the sale of shares and securities the nature of the profit has to be ascertained from the motive, intention or purpose with which they were brought. If the shares were acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature; but if the shares were acquired in the ordinary course of business as a dealer in shares, it would be a taxable receipt. If the shares were acquired with speculative motive the profit or loss although of a revenue nature would have to be dealt with separately from other besiness. In this context, it may be noted that the Explanation to Section 73 treats the business of purchase and sale of shares by companies, which are *not* investment, banking or finance companies, as speculation business. As a result, losses from such dealings will be set off only against gains from similar dealings in shares. Similarly, in the case of profits arising from the sale of land, buildings or other capital assets, the treatment for income-tax purposes would depend upon the motive and intention behind the transaction.

5. Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. It is not necessary that there must be repetition or opportunity or such transactions as to constitute an adventure in the nature of trade. Thus a bulk purchase followed by a bulk sale or a series of retail sales or a bulk sale followed by a series

of retail purchases would constitute an adventure in the nature of trade and consequently the income arising thererfom would be taxable. Therefore, a receipt to be of a revenue nature, it need not necessarily be repetitive or recurring. But every speculative transaction though isolated in nature is an adventure, but it need not necessarily be in the nature of a trade. Similarly, purchase of any article or capital asset with no intention to resell it, but resold under changed circumstances would be a transaction of a capital nature but not of business and consequently the profits arising therefrom would be capital gains and not busiuess income. However, where an asset purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature would depend upon (i) the conduct of the assessee, (ii) the nature and quantity of the article purchased, (ii) the nature of the operations involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

6. In the case of annuities which are payable in specified sums at periodic intervals of time the receipt would be of a revenue nature even though it involves the conversion of capital into income for an annuity means the purchase of an income. However, the fact that annuity is contingent or variable in amount does not in any way affect its character as income. Nevertheless, tax on the annuity is, to some extent, also a tax on capital or an equivalent of capital in so far as income includes any returns which come from the waste or use of capital *e g.*, leasehold quarries, etc. An annuity received from an employer is taxable as 'income from salaries' whereas all other annuities are chargeable under the head 'income from other sources' irrespective of the fact whether or not they are payable (i) under a testamentary or non-testamentary trust, (ii) under a deed of family arrangement (iii) under an insurance policy, (iv) under a deed of separation to a wife or under a decree of alimony, or (v) to the estate of deceased partner by the remaining partners for the use of the firm's name and goodwill.

Annual payments, as distinguished from annuities, are in fact annual instalments of capital. The purchase price of a business or property may be agreed to be paid in instalments annually or otherwise In such cases, the amount of instalments received by the assessee would be of capital nature not liable to tax. In order to ascertain whether a certain payment is an annuity or annual instalments of capital regard must be had to the true nature and character of the transaction as evident from the contract which embodies the transaction and other circumstances of the case. Thus on the sale of property of business in consideration of annual payment :—

(i) if the sale is for a price which is to be paid in instalments, the instalments would be capital receipts.

(ii) if the property is sold for an annuity payable regularly the property disappears and the annuity which takes its place would be chargeable to tax ;

(iii) if the property is sold for what looks like an annuity but actually there is no transmutation of the principal sum into income and the annual payments are merely instalments of the principal sum with interest only

so much of the amount of instalments as representing the interest payable would be income chargeable to tax, the balance being capital receipts ; and

(iv) if the property is sold for a consideration which is share of the profits or gross receipts of a business, the receipts of the share of profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However if the circumstances of the case show that the receipts were only instalments of a capital nature, though fluctuating in amount and measurable with refrence to profits, they would not be taxable.

7. Compensation received for restraint of trade or profession is a capital receipt since it is received in substitution of the source of income itself. But this principle does not apply in cases where there is a covenant not to manufacture materials and the compensation therefore merely forms an integral part of a composite agreement made in the ordinary course of business of procuring the supply of these materials Thus a receipt in substitution of a source of income is a capital receipt not chargeable to tax Where an assessee receives compensation of termination of the agency business—the agency business being the only source of income the receipt would be of a capital nature even though it is taxable under Section 28 (ii). But where the assessee has a number of agencies and one of them is terminated and compensation received therefore, the receipt would be of a revenue nature since taking agencies and exploiting the same for earning income is the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the contract of service would be a revenue receipt taxable under Section 15. Similarly, compensation received from Government (i) for use of requisitioned premises, (ii) in respect of stock in trade destroyed or damaged by enemy action, (iii) the property compulsorily acquired by the exercise of their powers in controlling and interfering with the business would constitute revenue receipts. But compensation paid for acquisition of Zamindari lands or leasehold property which constituted a capital asset in the hands of the lessee or compensation paid by the Government for cancellation of licence resulting in the cessation, temporary stoppage or injury to the business would be a capital receipt. In cases where the compensation received is partly of a capital and partly of a revenue nature, the two will have to be segregated and treated accordingly for tax purposes

8. A lumpsum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads. Amount received under a policy of insurance would be a capital or revenue receipt depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally a revenue nature since they would be to supplement the income from business. But where a grant is received for a specific purpose but not as a supplementary

trading receipt (*e.g.*, to enable the company to undertake work to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax. Premium or discount received by a debenture holder, being a capital receipt, would not be chargeable to tax Also the discount on loans made at a discount and repayable at a premium would be a revenue receipt in the hands of a person whose ordinary business is that of money lending In other cases, it would be a capital receipt Premium (salami) of single payment made for the acquisition by the lessee of the right to possess and enjoy the benefits granted to him under the lease of land or building is normally capital receipt since the right under the lease forms a capital asset However, where the payment of premium takes the character of advance rent (but not the price for parting with the land or building) the receipt would be taxable as income.

Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lumpsum or by way of a fixed annual sum or a tonnage royalty calculated on the basis of the amount of minerals extracted or the minimum royalty called as the dead rent. Similarly, royalties paid for use of patents in the past, present or future whether paid in lumpsum or in instalments of fixed or varying amounts would be taxable as income whereas the payment received in lieu of total or partial assignment of patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt since the assignment resulting in or from the sale or surrender of a patent is a transaction of a capital nature. These principles would as well apply to royalties received for the use of assignment of copyright, technical know-how or secret formula. Profit on exchange of currencies or on devaluation of currencies would be a revenue or capital receipt in nature depending upon the fact whether the foreign currencies are kept as stock-in-trade (*e g.* in the case of banks) or as an investment, *i.e* , capital asset. However, the profit element in the sale or assignment of the patent or similar rights or the exchange of these currencies would be chargeable to capital gains tax in cases where the receipts therefrom are of a capital nature.

Premium on issue of shares or debentures, profit on forfeiture of shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax, not even to capital gains tax since the shares or debentures are not capital assets of the company. The amount received by a shareholder on the winding up towards his share of asset of the company would not be a revenue receipt [except where the receipt falls within the meaning of the term "dividend" under Section 2 (22)] irrespective of the fact whether the company originally possessed these assets by way of capital or profits But in case of a partnership, the amount receivable by an outgoing partner in respect of his share of the firm's profit—whether, before or after its dissolution—would be a revenue receipt chargeable to tax. But compensation received by a partner for relinquishing all his interests in the firm and amounts received in settlement of a claim to an interest in the capital of a firm are capital receipts.

Apart from the foregoing discussion. it is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the parti-

cular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact

IV. Residence : The incidence of tax on any assessee depends upon his residential status under the Income tax Act and therefore, after determining whether a particular amount is capital or revenue in nature, if the receipt is of a revenue nature chargeale to tax, it has to be seen whether the assessee is liable to tax in respect of that income. The taxability of a particular receipt would thus depend upon not only on the nature of the income and the place of its accrual or receipt but also upon the assessee's residential status.

For all purposes of income tax, tax payers are classified into three broad categories on the basis of their residential status; *viz*. (i) resident (also) known as resident and ordinarily resident); (ii) resident but not ordinarily resident; (iii) non-resident.

Section 6 of the Act lays down three alternative tests of residence for individuals, two for companies and one for Hindu undivided families, firms, associations of persons and other taxable entities. An assessee's residential status must be determined in every case with reference to the period (and not the purpose or place) of his stay in India in the previous year or the accounting year (but not the assessment year). The residential status of an assessee must be ascertained with reference to each accounting year, and for this purpose it is not correct to proceed on an assumption that a person who is resident in one year would automatically continue to be so in the succeeding years as well. This is because of the fact that a person who is resident in one year may become non-resident or not-ordinary resident in another year *or vice versa*. In the following paragraphs the provision for determining the residential status of assessees have been discussed separately for individuals, companies, firms, Hindu undivided families and other taxable entities :

1. **Individuals** : An individual is said to be resident in India in any accounting year, if he :

(i) has been in India during that year for a total period of 182 days or more, or

(ii has either maintained or caused to be maintained a dewlling place in India for a total period of 182 days or more and has been in India for at least 33 days in that year.

(iii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

An Explanation to Section 6 (1) has been inserted with effect from 1st April, 1970. As a result of this Explanation, in the case of Indian citizens who are rendering service outside India and who come to India in any 'previous year' on *leave or vacation*' the period of "thirty days" and "sixty days" respectively referred to in (ii) and (iii) in the paragraph above would stand extended to ninety days. As a result of this relaxation, Indian citizens employed outside India would be able to stay on leave

or vacation in the home country for *eighty nine* days in a previous year, without becoming "resident in India" in that year This provision applies in relation to the assessment year 1979-80 and subsequent years.

Stay in India : Here it may be pertinent to note that all the above mentioned three tests are alternative and it is enough if an individual fulfills any one of them in order to be treated as resident in India. It may be noted that in all the three tests the most common and important factor is the individual personal stay in India during the previous year although the number of days of stay differ from one test to another. Thus, if an individual has been staying continuously outside India during the whole year, he must be treated as a non resident for that year. In order to fulfil the test prescribed for residence it is not necessary that the period of stay contemplated by the section must be continuous or active nor is it essential that the stay should be at the usual place of residence, business or employment of the individual. What is required is that the individual should have been in India, the place and duration of his stay at each place being totally immaterial for the purpose. A person who never stays at one place for two nights continuously may become a resident as per the provisions of the Act even though he cannot be treated as resident at any particular spot or place. Even the stay in a ship or boat moored in the territorial waters of India would be sufficient to make the individual resident in India. The residence of an individual for income-tax purpose has nothing to do with citizenship, place of birth or domicile. An individual can, therefore, be resident in more countries than one even though he can have only one domicile.

'Maintaining a dwelling house' : The expression "maintaining a dwelling house' in Section 6 (1) of the Income-tax Act means that the assessee owns, or has taken on rent or on a mortgage with possession a dwelling house which he can legally and as a matter of right occupy as and when he wants. The expression "has maintained for him a dwelling place" would cover a case where the assessee has a right to occupy or live in a dwelling place although the expenses of maintaining the dwelling place are not met by him, whether wholly or in part Thus in cases where a house is owned by the assessee in India and it is not shown that any body else is living there as of right or that it is not fit for occupation and there is also evidence to show the assessee visits or is likely to visit the place now and then, it can easily be said that the house is maintained by the assessee as a dwelling house in India. It is, however, necessary to see that not only the house is a dwelling house but it is also maintained, either by the assessee himself or by some one else for the assessee's residence. The Supreme Court recently held in *C.I.T. v K.S. Ratnaswamy (1980)* 3 Taxman 7, that maintenance of a joint family house in India by the manager of the family for the benefit of the family members other than the assessee would not amount to maintenance of dwelling place for the assessee even though the assessee was the owner of a fractional share in the family house with a consequent right to occupy the same, The volition on the part of the assessee in the maintenance of the dwelling place should emerge very clearly from the facts of the case. Whether he maintains it or he causes it to be maintained, the maintenance of the dwelling place must be at this instance

behest or request and when it is maintained by some one else other than the assessee, it must be for the assessee or for his benefit. But it must be noted although the maintenance of dwelling house is essential condition. it is not necessary that the assessee's stay must be in that house The requirement of the Section is only that the assessee must stay in India; it is immaterial whether the stay is in the dwelling house or any where else.

The maintenance of the dwelling house should be primarily for the individual himself although his family members, parents, or other friends and relatives may also stay there. However, even in cases where the individual owns a house but has allowed another to use it as his residence and no part of the house is set apart or maintained for himself he cannot be said to have maintained for himself a dwelling house in India. For the purpose of being considered as the maintenance of a dwelling house even, if the assessee regularly reserves a room in a hotel in India for his residence, he would be said to have complied with this condition. Under the second test it is essential that in order to become a 'resident' in India the individual should not only maintain a dwelling place in India for at least 182 days during the accounting year but must also have been physically staying any where in India for at least 30 days in that year (in the case of Indian citizens employed outside India who come on leave or vacation in India—90 days).

If an assessee does note satisfy either of the first two conditions. the third one may be applied to determine his residential status. According to the third test, the individual (i) must have stayed in India for a total period of at least 365 days during the four years immediately preceding the previous year, and (ii) must have been physically present in India for not less than 60 days (in the case of Indian citizens employed outside India on leave or vacation in India, 90 days) during the previous year. Both these conditions are cumulative in their application and unless both of them are satisfied the assessee could not be called a resident The four years referred to for this purpose would cover a period of four years of twelve calender months each, immediately preceding the commencement of the relevant accounting year. It may, however, be noted that the question of maintaining a dwelling house is totally immaterial in applying the first or third test for determining the residential status of an individual.

Amendments made by the Finance Act 1982

The Finance Act 1982 has effected the following amendments in Section 6(1) with effect from 1.4.1983.

It has omitted clause (b) of sub-section (1) of Section 6 and it has substituted a new explanation in place of existing explanation to Section 6(1), Accordingly the second test relating to the maintenance of a dwelling place in India for a period or periods amounting in all to one hundred and eighty two days or more in the relevant previous year and the stay in India for thirty days or more in that year will not be a test for residence with effect from 1.4.83.

The new Explanation substituted by the Finance Act 1982 provides for the following two situations :

(i) In the case of Indian citizen who leaves India in any previous year for the purpose of employment outside India, 182 days shall be substituted in the place of 60 days referred to in the third condition.

(ii) In the case of an Indian citizen engaged outside India either in an employment or a business or a profession or in any other vocation, who comes to India on a visit, 90 days shall be substituted in the place of 60 days stated in the third condition.

It may be noticed from the above that

(i) the test relating to maintenance of dwelling place for 182 days or more and personal stay for 30 days or more has been deleted

(ii) the relaxtion allowing a period of 90 days of stay in the case of Indian citizens. rendering service outside India (as per the Explanation to Section 6(1)) has been extended to cover Indian citizens engaged either in business or profession or any vocation also; and

(iii) Indian citizens leaving India in any previous year for employment outside India shall be non-residents unless their aggregate period of stay during that year is 182 days or more. It may be noted that there is no change in the provisions of Section 6(6) dealing with not ordinarily residents.

The above amendments are applicable in relation to the assessment year 1983-84 and subsequent assessment years.

2. **Hindu undivided families, Firms or other Association of Persons** : A Hindu undivided family, firm or other association of persons would be resident in India if the control and management of its affairs is situated *wholly or partly* in India. In other words only in cases where the control and management of the affairs is situated wholly outside India the assessee would become a non-resident. In view of the fact that even a partial or even negligible control and management of the affairs is sufficient to make the H.U.F. or firm resident in India the assessee may sometimes have more places of residence than one.

For purposes of determining the residential status of a firm or a H.U.F., the residential status of the partner of the firm or the members of the H U.F., is immaterial except in cases where the residence of the partners or the members of the family affects its control and management. Therefore, the mere fact that all the partners of a firm are residents in India need not necessarily imply that the firm is also resident in India, because it may so happen that the entire control and management of the affairs of the firm might be exercised from outside India.

Control and Management : The expression 'control and management' referred to in Section 6 of the Act refers to the central control and management and not the carrying on of day-to-day business by servants, employees or agents. The business and the whole of it may be done from outside India and yet the control and management of that business may be wholly within India. Therefore, in order to determine the residential status of the assessee the real test to be applied is : "*Where does the cont-*

rolling and directing power function ? or Where is its head and brain"? In order to hold that a H.U.F. or a firm is resident in India during the accounting year it must be established that the assessee *de facto* (and not *de jure*) controlled and managed its affairs in India at least partially.

Therefore control and management of a business is said to be situated at a place where the head and brain of the adventure is situated. The place of control may be different from the usual place of running the business and sometimes even the registered office of the assessee This is because of the fact that the control and management of a business need not necessarily be done from the place of business or from the registered office of the assessee. But control management do imply the functioning of the controlling and directive power at a particular place with some degree of permanence.

3. **Companies** : A company is said to be resident in India if (a) it is an Indian company as defined in Section 2 (26) or (b) the control and management of its affairs is situated *wholly* in India during the accounting year. Thus every Indian company is resident in India irrespective of the fact whether the control and management of its affairs is exercised from India or outside. But a non Indian company (whether it is domestic company or a foreign company) would become resident in India if the control and management of its affairs is exercised wholly from India. In other words, even if a negligible part of the control and management of the affairs of the non-Indian company is situated outside India it would be a non-resident company for all purposes of Income-tax. Therefore, in order to become resident in India a foreign company or a domistic company (which is not an Indian company), must have the control and management of its affairs exercised wholly from India.

The test to be applied to determine the residential status of a company on the basis of the control and management of its affairs are exactly opposite to those applicable to firms or Hindu undivided families. In the case of non-Indian companies the entire control and management must be exercised from India in order to make it a resident assessee whereas, in the case of a firm or H.U F, it is enough even if a very negligible part of the control is exercised from India The control and management of the affairs of company are said to be exercised from the place where the meetings of the board of directors are held, decisions taken and directions issued. For the purposes of determining residential status of a company, the residential status of the members of the board of the directors or the secretary and other principal officer of the company would be totally immaterial As in the case of other assessees the residential status of non-Indian companies must be determined with reference to each accounting year since a company may change the place of its control and management and consequently the place of its residence may also change. The management and control of a company's affairs is situated at the place where directors' meetings are held but not at the place where shareholders meetings are held. Control here means *de facto* control and not merely *de jure* control The immediate but not the ultimate power of control matters here. Therefore, the fact, that a company is resident in India in one year does not necessarily mean that it would be or would have been resident in all the subsequent or earlier years as well.

Other assessees : The residential status of all the other assessees, being local authorities or artificial judicial persons (*i.e.*, idols, deities) should be determined by ascertaining whether the control and management of the affairs of the assessee is exercised from India or outside. For this purpose, it is immaterial whether the amount of control exercised from India is the whole or only a part thereof. Therefore, any assessee (other than an individual. H.U.F., firm, company or an association of persons) would be resident in India in any accounting year if even a negligible part of its control and management is exercised from India. In other words, unless the whole of the control and management of the affairs of the assessee is exercised from outside India, it will continue to be resident in India.

It must be noted that since an assessee can have as many accounting years as he has sources of income, he would be resident in India in any year in respect of all of his sources of income even if he is resident in India in respect of the accounting year for any one of his sources of income. In other words, only in case where the assessee cannot be called resident in India in respect of all of his sources of income taxable in India he could be said to be non-resident in India

Non-resident : A non-resident is one who is not resident in India during any of the accounting years relevant to the assessment year concerned. In order to determine whether a person is non-resident or not in respect of any previous year it is essential to ascertain his residential status on the basis of the various tests discussed above with reference to each of his sources of income if they are more than one. Unless the assessee can be said to be resident in India in respect of the accounting year for any one of his sources of income he cannot be called a resident and consequently any person who is not a resident would be non-resident Further, an assessee not satisfying the tests above would be a non-resident irrespective of the fact whether the assessee is an individual, H U F . firm company or any other person taxable under the Act

Not ordinarily resident · Only individuals and Hindu undivided families can be resident, but not ordinarily residents in India. All other classes of assessees can be only resident or non-resident but not ordinarily resident in India for purpose of Income-tax A not ordinarily resident person is one who satisfies the condition specified in Section 6 (6). Individuals and Hindu undivided families satisfying the various conditions discussed earlier in order to ascertain whether they are resident or not *must in addition*, satisfy both the following conditions so as to become a resident and ordinarily resident in India.

An individual would be resident and ordinarily resident in India *only if* (a) he has been resident [within the meaning of Section 6 (1) as discussed earlier] in India in nine out of the ten preceding previous years *and* (ii) had, during the seven previous years preceding that year, been physically present in India for a total period of at least 730 days. This would make it clear that an individual who does not apply either or both of the above two conditions would be resident but not ordinarily resident in India Therefore, a newcomer to India would be a not ordinarily resident in India for the first nine years of his stay in India and an ordinarily resident would,

on his return, become a not-ordinarily resident if he stays *outside India or remains non-resident in India for two years.*

A *Hindu undivided family* is deemed to be resident and ordinarily resident in India if its manager or karta is resident and ordinarily resident in India according to the above tests applicable to individuals. For this purpose the periods of stay of successive managers of the H.U.F. in India during its continued existence should be added up.

Some Illustrations :

(1) Mr. A, closes his books of account every year on 31st March. He left India for the first time on 27th April, 1982 on a worldwide tour. He came back to India on 2nd April, 1983. But he maintained his dwelling house in Calcutta during his absence also. Determine the residential status of Mr. A for the assessment year 1983-84.

Answer : As Mr. A closes his books of account on 31st March his previous year relevant for the assessment year 1983 84 shall be the year ending 31st March, 1983 (i.e 1st April, 1982 to 31st March 1983).

Under the Income-tax Act, the residential status of an individual shall be determined as per the provisions embodied in Section 6(1) and 6(6). In Section 6(1) *two alternative tests* are prescribed for this purpose. The residential status of an individual depends upon the satisfaction of any one of these three tests which are discussed below.

(a) Under Section 6(1)(a), an individual should have stayed in India for a period or periods amounting in all aggregate to 182 days or more during the previous year. In this case Mr. A stayed in India for only 27 days during the previous year hence this test is not fulfilled.

(b) Two conditions of cumulative nature are set out in Section 6(1)(c) viz., (1) the individual should have stayed in India for 365 days or more during the four years preceding to the previous year and (2) he should have been in India for 60 days during the relevant previous year. Mr A satisfies the first condition as he stayed in India continuously upto 27th April 1982 but he does not satisfy the second condition as he stayed in India for 27 days during the previovs year. As he does not satisfy one of the two conditions, he has not fulfilled this test also.

Mr. A does not satisfy any one of the two alternative tests prescribed under Section 6(1). So he is a non-resident. The question of applying the provisions of Section 6(6) does not arise in this case as he is not a resident

Hence Mr. A is a non-resident for the assessment year 1983-84.

(2) Mr. Y maintains no books of accounts. He was sponsored by his employer for some training in U.S A. He left India on 3rd June 1982. But his family continued to stay in the house owned by Mr. Y in New Delhi. He came back to India on

9th April 1982. Determine Mr. Y's residential status for the assessment year 1983-84 assuming that he did not go out of India previously.

Answer *: As Mr. Y does not maintain any books of account, his previous year shall be the financial year. For the assessment year 1983-84 the relevant previous year shall be the year ended 31st March 1983 (i.e 1st April 1982 31st March 1983).*

Under the Income-tax Act, the residential status of an individual shall be determined as per the provisions of Sections 6(1) and 6(6). Section 6(1) contains two alternative tests

(a) He should have stayed in India for a period of 182 days or more. The assessee Mr. Y does not satisfy this as he stayed in India only for 64 days during the previous year.

(b) He should have stayed in India for 365 days or more during the four years preceding the previous year and he was present in India for 60 days during the previous year. Mr. Y satisfies both the conditions as he was present in India continuously upto 3rd June, 1982 (i.e., more than 365 days during the four years preceding the previous year) and for more than 60 days. (The application of 90 days does not arise here as the assessee did not visit India from U.S A. while he was undergoing training there). According to this test Mr Y is a resident.

Since Mr. Y satisfied the tests prescribed under Section 6 (1) he shall be treated as a resident Now the provisions of Section 6 (6) (a) are to be applied to determine whether he is resident but not ordinarily resident The conditions are alternative. Even either of them is satisfied he shall be treated as resident but not ordinarily resident. The conditions u/s 6 (6) (a) and their application in this case are as follows. Under the above Section an individual who is not a resident in nine out of ten previous years preceding the year in question or his total stay in India during seven years preceding the relevant previous year was less than 730 days, shall not be an ordinarily resident. In this case the assessee must have been resident in India for all ten years preceding the relevent previous year and he was physically present in India for more than 730 days during the seven years preceding the relevant previous year as he did not go out of India previously. So he has not satisfied both the conditions set forth in Section 6 (6) (a). Hence he is a resident and ordinarily resident.

3. Mr. P an Indian citizen left for the first time to take up a new assignment as an Engineer in Dubai on 28th March 1981. He let out his house to one of his relatives. He came back to India on 1st June, 1982 on leave to attend his brother's marriage and remained in India upto 15th August, 1982. (i) Determine the residential status of Mr. P for the assessment year 1983-84 (ii) will be there any change in Mr. P's residential status if he had stayed in India from 1st June, 1982 to 20th September, 1982 due to prolonged illness? Explain such change if any.

Answer: As it is not given in the question that Mr. P maintains books of account it is presumed that he does not maintain them. In that case his previous year shall be the financial year. Hence, for the assessment year 1983-84, his previous year

shall be the year ended 31st March, 1983 (i.e., 1.4.1982 to 31.3.1983). Mr. P's residential status has been determined in the following manner by applying the provisions of Section 6.

(1) His total stay in India during the previous year was (only 76 days) less than 182 days as required u/s 6 (1) (a).

(2) He left India on 28th March, 1981. Four years preceding to the previous year in this case mean four calendar years preceding 1st April 1982 i.e., 1st April 1978 to 31st March 1982. During this period Mr. P stayed in India from 1st April 1978 to 28th March 1981 i.e., 1093 days So he stayed for a period of more than 365 days as required by one of the conditions u/s 6 (c). But his total stay in India during the previous year was 76 days i.e. 14 days short of required stay of 90 days as per the Explanation to Section 6 (1) (c) (as the assessee is an Indian citizen employed outside India and has come on leave, the aforesaid explanation is applicable). Since the two conditions u/s 6 (1) (c) are cumulative and either of them is not satisfied, he *is not a resident.*

As Mr. P has not *satisfied either of the two alternative tests, he* is a non-*resident for the assessment year 1983-84.*

B. *If Mr. P stayed in India from 1st June 1982* to 20th September *1982 i.e.* for 112 days, his residential status shall be different. Despite the change in the number of days he stayed in India, the impact of the provisions of Sec. 6 (1) (a) would not differ from the position explained in the above paragraphs. However the impact of Section 6 (1) (c) differs in the present context as explained below :

(1) His total stay in the four years preceding the previous year were more than 365 days (i.e. 1093 days).

(2) He stayed in India during the previous year for 112 days against the requirement of 90 days. The reasons for such stay are not material facts to be considered for this purpose. So he satisfies both the cumulative conditions set in Sec. 6 (1) (c). Hence he is a resident. Now the question of whether he is a resident but not ordinarily is to be looked into by applying the provisions of Sections 6 (6) (a). Under Section 6 (6) (a), an individual should not have been (1) a resident in nine out of ten years preceding the relevant previous year or (2) present in India for more than 729 days to be considered as a not ordinarily resident. In this case Mr. P does not satisfy both the conditions because Mr. P. was resident for all the previous year upto the year ending on 31st March 1981 (as he did not go out of India earlier than 28th March 1981). He was not resident for only one year 1981-82 preceding the relevant previous year. That means he was resident for nine out of ten years preceding the relevant previous year. He stayed for more than 729 days during the seven years preceding the relevant previous year. Hence he is a resident and ordinarily resident

V. Total Income and its scope : The expression 'total income' is of utmost significance in the study of income-tax as the tax is to be charged on the total income of the assessee. Section 5 of the Act provides the meaning of total income in terms of

the residential status of the assessee because the incidence of tax on any person depends upon his residential status. For all purposes of assessment the gamut of taxation and the scope of total income of an assessee depend upon three important considerations : *viz*. (i) the residential status of the assessee (as dicussed earlier) (ii) the place of accrual or receipt of income, whether actual or deemed : and (iii) the point of time at which the income had accrued to or was received by or on behalf of the assessee. The ambit of total income of the three classes of assessees would be as follows :

1. **Resident (and ordinarily resident)** : The total income of a resident assessee would, under Section (5) (1) consist of—

(i) income received or deemed to be received in India during the accounting year irrespective of the place or date of its accrual ;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the accounting year—the date or place of its receipt being immaterial and

(iii) income which accrues or arise outside India even if it is not received or brought into India during the accounting year.

2. **Resident but not ordinarily resident** : The computation of total income of a person who is resident but not ordinarily resident would be the same as in the case of residents stated above *except* for the fact that the income accruing or arising to him outside India is not to be included in his total income. However, the foreign income *must* be included in the total income of the assessee in all cases where (i) the income is derived from a business or profession set up in or controlled from India or (ii) the income is deemed to accrue or arise in India under Section 9 of tne Act or (iii) the income is deemed to be received in India. These provisions are contained in the Proviso to Section 5 (1) of the Act.

3. **Non-resident** : A non-resident's total income under Section 5 (2) includes :

(i) income received or deemed to be received in India in the accounting year, the place or date of its accrual being immaterial and ;

(ii) income which accrues or arises or is deemed to accrue or arise in India during the previous year, the date and place of its receipt being immaterial.

From the above paragraphs it may be noted that assessees whether resident or not, are chargeable to tax in respect of their income accrued, arisen, or received, deemed to accrue, arise or to be received in India whereas residents alone are chargeable to tax in respect of income which accrues or arises and received outside India.

The meaning of the expression 'total income' for this purpose shall also include any income which is includible in the total income but qualifies for rebate at the average rate of tax or for deduction from the gross total income under Chapter VIA of the Act The fact that a certain receipt is exempt from tax would not in any way exclude the same from being included in the total income although the entire income of the assessee is not necessarily subjected to tax in full. This is because of the fact

that the total income of an assessee may consist in certain circumstances, of incomes which are totally exempt from tax under Sections 10 to 13 and those which qualify for deduction or rebate under Sections 80A, 86, 86A. The total income of an assessee should therefore, be taken to include all income from whatever sources derived.

Meaning of "*Income received or deemed to be received*" : All assessees are liable to tax in respect of the income received or deemed to be received by them in India during the previous year irrespective of (i) their residential status and (ii) the place of its accrual or arising For this purpose both 'actual and constructive' receipt of income either by the assessee himself or by someone else acting on his behalf must be taken into account and the aggregate sum of all such receipts must be included in the assessee's total income. The following are instances of such constructive receipts; payment of income tax, insurance premium and deduction on account of contribution to provident fund from the employee's salary, conversion of a debt into a fresh loan or deposit by a creditor, adjustment of amount due from a person towards the payment made to him in exchange of one asset with another in the course of a sale or transfer, etc.

The Superme Court held in *C.I.T. v. Toshoku Ltd. (1980) 4 Taxman 1*, that making of the entries in the books of account of a 'statutory agent' of a non-resident regarding the commission payable to the non-resident assessee did not amount to receipt by the non-resident, as the amounts so credited in his favour were not at his disposal or under his control. In such circumstances, the credit balance only represented a debt and a mere book entry in the debtor's own books did not constitute payment which would secure discharge from the debt. In such a case he could not be charged to tax on the basis of receipt of income, either actual or constructive in the taxable territories during the 'relevant accounting year'. However, when the amount credited by book entries is at the disposal of the non-resident, the amount would be taxable on the basis of constructive receipt, as held by the Supreme Court in the case of *Raghav Reddi v. CIT (1962) 44 ITR 723 [S.C]*.

The assessee would be presumed to have received the income at the first instance even if the same was received twice. Income is to be included in the total income of the assessee immediately on its actual or deemed receipt. The receipt of income contemplated in the Act refers only to the receipt after its accrual and means only the first occasion when the recipient gets the money under his control. Therefore, when once an amount is received as income, remittance or transmission of that amount from one place or person to another does not constitute receipt of income in the hands of the subsequent recipient or at the place of subsequent receipt. Consequently, there will be no liability to tax in respect of subsequent receipt since it is not at all treated as receipt of income for the purpose of income-tax

It must, however, be noted that receipt of income is not the sole or only test of taxability; income would be taxable when once it becomes due to the assessee or on accrual whether it is actually received or not. The taxability of a certain item as income would depend upon the method of accounting followed by the assessee. This

is because of the fact that under the cash system of accounting an item of income would be taxable only when it is received by the assessee himself or on his behalf But under the mercantile system an item of income would be taxable when once it becomes due to the assessee i.e., when once the assessee gets the legal right to claim the amount whether it is actually received or not. Although the liability to tax of a particular item of income depends generally on the method of accounting regularly employed by the assessee, it has specifically been provided in the Act that in the case of income from salaries and interest on securities, the liability to tax arises immediately when the income is due to the assessee irrespective of the method of accounting followed by the assessee and also regardless of the question of its actual receipt. Likewise in the case of dividends, the income would be included in the total income of the shareholder under Section 8 in respect of the year in which the final dividends are declared and, in the case of interim dividends in respect of the year in which they are made unconditionally available to the shareholder, the date of actual receipt in either case being immaterial for the purpose

However, the date of receipt of income would be the basis of determining the assessee's tax liability in all cases where the accounts are maintained on cash basis. This is because of the fact unless the income is received by the assessee during the accounting year, it cannot be charged to tax in his hands for that year.

It must also be borne in mind that method of accounting determines only the taxability of the income but not the date or place of receipt of the nature of the income.

Income deemed to be received: According to Section 7, the following items of the income must be deemed to be received by the assessee during the previous year irrespective of the fact whether he had actually received the same or not :

(i) The annual accretions in the previous year to the balance to the credit of an employee participating in a recognised provident fund to the extent provided in Rule 6 of Part A of the Fourth Schedule to the Act.

(ii) The transferred balance in a recognised provident fund to the extent provided in Rule 11 (4) of Part A of the Fourth Schedule.

Meaning of income 'accruing' and 'arising': The words 'accruing' and 'arising' have been used in the Act in contradistinction to the word 'receipt' and refer to the 'right to receive' income. The meaning of the term 'receipt' in respect of liability to income-tax has already been explained earlier Income is said to accrue at a point of time prior to its quantification or computation which is not a condition precedent to its accrual. For instance, interest on Government securities is usually payable on specified dates, say on 1st January and 1st July. In all such cases, the interest would be said to accrue from 1st July to 31st December and on 1st January it will fall due for payment. Likewise, salary which is payable on the first day of the month would be said to accrue say from 1st December to 31st December and on 1st January it will fall 'due' for payment Likewise, salary which is payable on the last day of the month would be said to accrue from the beginning

of the month and it becomes due on the last date when it is to be paid. Thus 'accrue' will refer to the right to receive the income whereas 'due' will refer to the right to enforce payment of the income. In other words, income cannot be said to be due to the assessee when it has only accrued to him ; but income which is due to the assessee would necessarily mean that it has already accrued to him. But it must be noted that income can be said to accrue or arise only in case where the accrual of the income is certain and its amount is easily determinable If there is uncertainty in regard to the quantum of income or the assessee's right to claim the amount, income cannot be said to accrue to the assessee and consequently the question of liability to tax on such items on the basis of accrual does not arise.

The words 'accrue' and 'arise' though appear synonymous do not mean the same thing so far as the date of the receipt is concerned. Therefore, income which accrues in an accounting year may not also arise in the same year and this is possible mostly in cases where the assessee follows a hybrid system of accounting. Income is said to accrue when it first comes into existence or the right to receive the same comes into being but it is said to arise only when the method of accounting shows it in the form of profits and gains.

In all cases where the question of accrual of income is being considered, it is very essential to ascertain the time of its accrual, the persons to whom it could be said to have accrued and the place of its accrual. Only when these facts are ascertained, it would be possible to make a correct assessment on the assessee in respect of the income. For this purpose, income can be said to have accrued only when assessee acquires the right to receive the same. Further, income can be said to accrue only to the person who is legally entitled to claim it as on the date of its accrual. Income would be said to accrue at the place where the contract yielding the income is entered into and for this purpose the contract would said to have been entered into at the place where the offer is accepted by the offeree or on his behalf. In other words, income would be said to accrue at the place where the business is carried on or the source of income is situated. The place of accrual or receipt of income is very important mostly for the assessment of non-resident.

Income deemed to accrue or to be received in India : An item of income can be deemed by a fiction of law, to accrue or to be received in India in case where the income does not actually accrue or is received in India. The clear implications of this phrase are that—

(i) the income does not accrue or is not received in reality at all ;

(ii) in fact it accrues or is received but not in India :

(iii) it is deemed to be the income of the assessee although in reality it is the income of another person ; or

(iv) it is deemed to be the income of the accounting year whereas it may actually be the income of a different year.

The expression "income deemed to accrue or to be received in India," specifically provides for the artificiality of income in regard to the time and place of accrual

or receipt, the chargeability of a person other than the actual owner of the income and the year of taxability. As a result, income accruing in foreign country in the name of another person at a different point of time may be deemed to be the income of the assessee during the pervious year.

The foreign income of an assessee would not, however, be deemed to have accrued or been received in India in cases where all the following conditions are satisfied *viz*.

(i) The assessee is a person resident but not ordinarily resident in India.

(ii) The income accrues or arises in India.

(iii) It is not deemed to accrue or arise in India nor it is received or deemed to b received in India.

(iv) It is not derived from a business controlled from or a profession set up i India.

Therefore, in cases where these conditions are satisfied, the income would b taxable in India by including it in the assessee's total income. In other words, if th above conditions are not fulfilled, the income cannot be included in the total incom of these assessees.

The total income of non-resident assessee would consist of (i) income receive or deemed to be received in India even if it accrues elsewhere and (ii) income which accrues or is deemed to accrue in India even if it is received elsewhere. Non-residents are assessable on their total income at the rates applicable to them regardless of their other foreign income or the total world income. Where a business of an indivisible nature is carried on by a non resident in more countries than one the profits attributable to the business operations carried out in India alone should be included in the total income.

In case where the assessee is a firm, whether registered or unregistered, the residential status of any of the partners is immaterial for the purpose of ascertaining the residential status and consequently the total income of the firm. In view of this position, a non-resident partner of a registered firm or an unregistered firm cannot exclude from his total income a proportion of his share of firm's income corresponding to that portion of the income of the firm which accrued or arose to it outside India.

With a view to removing difficulties and clarifying doubts in the taxation of income, Explanation 1 to Section 5 specifically provides that an item of income accruing or arising outside India shall not be deemed to be received in India merely because it is taken into account in a balance sheet prepared in India. In view of this provision, even if the foreign income is included in a balance sheet and is also included in the profits distributed as dividends, the foreign income cannot be deemed to have been received by the concerned company in India and would not consequently become taxable in India.

Further, Explanation 2 to Section 5 makes it clear that when once an item of income is included in the assesee's total income and subjected to tax on the ground of its accrual or receipt, it cannot again be included in the person's total income and subjected to tax either in the same or in a subsequent year on the ground of its receipt - whether actual or deemed. In order to tax a particular item of income on its receipt or on its accrual the basis should be the method of accounting regularly followed by the assessee. The provision is specifically intended to ensure that double taxation of the same income—once on its accrual and then on receipt—is avoided.

VI. **Income deemed to accrue or arise in India (Section 9) :** Under this Section certain types of income are artificially deemed to accrue or arise in India even though they may actually accrue or arise outside India. The scope of this Section is only to shift the place of accrual of the income but not to shift in any way the ownership or title of assessee to the income. However, this Section applies to all assessees regardless of their residential status, citizenship, domicile, place of residence or business, nationality or relationship with persons in India But this Section would not have any application to all those cases where the income actually accrues or arises in India or is received or deemed to be received in India. In view of the fact that income deemed to accrue or arise in India is taxable in every case regardless of the status of the assessee the implications of this Section are of utmost importance to all taxpayers and persons who are not ordinarily residents in India who in the absence of this provision would be exempt from tax in respect of their foreign income.

The categories of income which are deemed to accrue or arise in India are :

(i) Any income accruing or arising to an assessee in any place outside India whether directly or indirectly (a) through, or from any business connection in India ; (b) through or from any property in India ; (c) through or from any asset or source of income in India : or (d) through the transfer of a capital asset situated in India.

(ii) Income from "Salaries, (a) which is earned in India or (b) which is payable by the *Government to a citizen of* India for services rendered outside India.

(iii) Dividends paid by an Indian company outside India.

(iv) Interest, ;

(v) Royalty ;

(vi) Fees for technical services

Income from business connection In all cases where income accrues or arises outside India to any person by virtue of his business connection in India, the income which arises outside India must be deemed to accrue or arise in India. The expression 'business connection' used in this context means a financial relationship which connotes some elements of continuity between the person in India who helps to make the profit and the person outside India who receives or realises the profits. But an isola-

ted transaction between a non-resident and a resident in India without the course of dealing which would be described as business connection does not attract the provisions of Section 9 (1) (i).

In other words, a business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in India which contributed directly and indirectly to the earning of those profits and gains. It predicts an element of continuity between the business of the non-resident and the activity in India; a stray or isolated transaction is not normally to be regarded as a business connection for this purpose. The meaning of 'business connection' is very wide, but it is also uncertain since it does not admit of any precise definition. Therefore, the question whether there is businees connection, in any particular case or not will have to be decided depending upon the facts and circumstances of each case.

However, a relation to be a business connection, must be real and intimate and through or from which income must accrue or arise whether directly or indirectly to the non-resident. All that is necessary is that there must be : (i) a business in India (ii) a connection between the non resident and the business, and (iii) the non-resident should directly or indirectly derive income through such connection. But the expression 'business connection' is totally different from though related to the carrying on of a business. In particular, the following are illustrative instances of a non-resident having business connection in India :

(i) Maintaining a branch office, factory, agency, receivership or management for the purchase or sale of goods or transacting any other business.

(ii) Appointing an agent in India for the systematic and regular purchase of raw materials or other commodities or for the sale of the non-resident's goods for business purposes ;

(iii) Erecting a factory in India where the raw products purchased locally is worked into a form suitable for export abroad;

(iv) Forming a local subsidiary company to sell the products of the non resident parent company ;

(v) Having financial association between a resident and a non-resident company;

(vi) Granting a continuing licence to a resident to exploit for profit an asset belonging to a non-resident even if the transaction might be disguised as out and out sale,

Some of the important instances of business connection as stated above would be cases of—(a) Non-resident exporter selling goods from abroad to Indian importers; (b) Non-resident company selling goods from abroad to its Indian subsidiary; (c) Sale of plant and machinery to an Indian importer on instalment basis; (d) Foreign agents of Indian exporters; (e) Non-resident person purchasing goods in India: (f) Sales by a non-resident to Indian customers either directly or through agents. The

mere fact that a substantial part of the goods produced by the non-resident is found in the Indian markets or is sold directly or through brokers to various customers in India or the more rendering of services outside India by a person carrying on business in India or the mere canvassing of sale promotion activities by a commission agent in India with no authority to accept orders or to enter into contract within the meaning of Section 9 (1) (i) and, therefore, any income arising to the non resident in such cases could not be deemed to accrue or arise in India.

The Supreme Court held in *B P. Ray v. I T O. (1981) 129 I T R. 295*, that the expression business connection Section 9 (1) (i) would cover 'professional connection' also.

Exceptions : There are two exceptions to the above provisions which are contained in explanations (b) and (c) to clause (i) of sub-section (1) of Section 9. The exception contained in (b) has been made specially to encourage exports from India. Accordingly, no income shall be deemed to accrue or arise to a non-resident in India through or from operations which are confined only to the purchase of goods in India for the purpose of exports. But this exception would not be applicable to resident and not ordinarily residents. The exemption would apply to all non-residents irrespective of the fact whether or not (i) the non-resident keeps an office or agency in India for the purpose or (ii) the goods, before their exports were subjected to manufacturing process or on behalf of the non resident.

Explanation c) to sub-section (1) of Secton 9 provides that in the case of a non resident, no income will be deemed to accrue or arise in India to him through or from activities which are confined to the collect on of news and views in India for transmission out of India This exception applies only to those non-residents who are engaged in the business of running news agency or of publishing newspapers, magazines or journals. This new explanation has been inserted by the Finance Act 1983 with retrospective effect from the assessment year 1962-63

Income from Property, Asset or Source of Income : The meaning of the expression 'property' used in Section 9 (1) (i) is wide enough to cover both movable and immovable property but it would not, however, include intangible assets such as goodwill, a debt or a chose-in action. Income arising in a foreign country from or through the property (*e g* hire charges or rent paid for the use of the machinery or buildings of the assessee which, under an aggreement are payable outside India) shall be deemed to accrue or arise in India. But this does not mean that the foreign income from intangible assets would totally not be deemed to accrue or arise in India. Income from tangible assets would certainly be deemed to accrue or arise in India as being income arising from or through any asset or source of income (but not from property). Examples of income arising abroad from an asset or source of income would be interest on loan payable or price paid for the use of goodwill outside India.

Income from the transfer of a capital asset : Capital gains arising from the transfer of a capital asset situated in India would be deemed to accrue or arise in India in all cases irrespective of the fact whether—(i) the capital asset is a movable or immo-.

vable, tangible or intangible asset; (ii) the place of registration of the document of transfer etc., is in India or outside; and (iii) the place of payment of the consideration for the transfer is within India or outside.

Allocation of Income : Explanation (a) to Section 9(1) (*i*) read with Rule 10 of the Income tax Rules provides for allocation of profits in respect of the different operations of a single business Thus in cases where the operations of a business are carried out partly in India and partly outside India, the income from business deemed to accrue under this Section is to be taken to be only such part of the income as is reasonably attributable to the operations carried out in India. A typical example of a case where such an allocation is essential will be cases where goods manufactured in one place and sold in another wherein the allocations of profits will be between the manufacturing and selling operations. However, the apportionment should be on a reasonable or rational basis but should not be arbitrary.

In cases where the income attributable to the operations carried out by an assessee in India could not definitely be ascertained, the amount of such income for purposes of assessment should be calculated—

(a) at such percentage of the turnover so accruing or arising as the I.T.O may consider to be reasonable having regard to the facts and circumstances of the case;

(b) on any amount which bears the same proportion to the total profits and gains of the business of the assessee computed in accordance with the provisions of the Income-tax Act as the receipts of accruing or arising bear to the total receipts of the business . or

(c) in such manner as the I.T.O. may determine.

Income from salaries : Under Section 9(1)(ii), income which falls under the head 'salaries', would be deemed to accrue or arise in India, if it is earned in India. Thus, salaries earned in India, i. e., for services in India, wherever paid, are deemed to have accrued or arisen in India for chargeability to income-tax.

The only *exception* to this rule is that pensions payable outside India by the Government to certain categories of persons (*i.e.*, Government officials and judges) who permanently reside outside India, shall not be deemed to accrue or arise in India, This exception is contained in sub-section (2) of Section 9 of the Act. In veiw of this provision all salaries payable to employees for services rendered in India, whether by the Indian Government or other employers or by foreign Government and bodies would be deemed to accrue in India and would consequently be taxable in India. For this purpose, the *residential status and citizenship of the employer or the employee would be totally immaterial. It may however, be noted here that the salary of an employee in the United Nations Organisation or in its constituent bodies is* exempt under United Nations (*Privilege and Immunity*) *Act.* ***However the question*** whether even the pensions received by such officers on ***retirement are exempt is under*** judicial debate.

It is significant to note that Gujarat High Court held in *C.I T. v. S.G. Pgnatale* (1980) *124 I.T R. 391*, that the words earned in India occurring in Section 9 (ii) must be interpreted as arising or accruing in India. It was further held that so long as the liabilities to pay the amount under the head 'salaries' arises in India clause (ii) can be invoked. *If the liability to pay arise outside India and the amount is payable outside India clause (ii) cannot be invoked In this view of the matter, the court held that 'retention remuneration' paid to a foreign technician outside India, under a specific agreement, for services rendered in India was not 'salary earned in India'* within the meaning of Section 9 (1) (ii).

To supersede the judgment of the Gujarat High Court in *S G. Pgnatale's case*, a new explanation has been inserted by the Finance Act, 1983 with retrospective effect from the assessment year 1979-80. As per the explanation, income chargeable under the head 'salaries' payable for services rendered in India shall be regarded as income earned in India As a result salary in respect of services rendered in India shall be deemed to accrue or arise in India by virtue of Sec 9 (1) (ii) even if the liability to pay such salary arises outside India.

Salaries payable by the *Government* to a *citizen* of India for services rendered outside India would be deemed to accrue or arise in India regardless of the place of actual receipt or accrual of the salary income. The salary of Government servants working abroad, who become non-residents after some time, would thus be deemed to accrue or arise in India and would therefore, be taxable in India. However, the perquisites, benefits or other special allowances paid or allowed to those non-resident Government servants would not be deemed to accrue in India since they are wholly exempt from tax under Section 10 (7) of the Act. Salaries paid by the Government to the citizen of other countries would not be deemed to accrue in India since the provisions of Section 9 (1) (ii) apply only to the salary payable to Indian citizens and not those payable to foreign citizens.

Income from Dividends : All dividends paid by an Indian company must be deemed to accrue or arise in India irrespective of (i) the residential status or citizenship of the shareholder ; (ii) whether the shareholder is a company or non-company assessee; (iii) whether the dividends are interim or final dividends : and (iv) whether the dividends are payable on equity shares, preference shares or bonus shares. The dividends declared abroad and paid abroad would in the absence of this provision not be taxable in India even though the company may be Indian and the situs of the shares (i e., the place where the share register of the company is kept; this is usually the registered office of the company) may be in India. For the purpose of taxing such dividends as deemed income of the shareholders the date and place of actual receipt of the income would be wholly irrelevant. But the dividends declared by a foreign company *cannot be deemed to accrue in India under this provision even if the foreign company is resident in India by virtue of its control and management being situated in India*

***Taxation of Royalty, Interest and Fees for Technical Services* : A non-resident taxpayer** is chargeable to tax in India in respect of income from whatever source derived

(ii) the imparting of any information concerning the working of or the use of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning financial, industrial, commercial or scientific knowledge experience or skill ;

(v) the transfer of all or any rights (including the granting of licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution of exhibition cinematographic films

The definition of 'royalty' for this purpose is wide enough to cover both industrial royalties as well as copy right royalties. The deduction specially excludes income which would be chargeable to tax under the head 'capital gains'.

Fees for technical services : The new clause (vii) of sub-section (1) of Section 9 deals with fees for technical services. Income by way *of fees for technical services* will be deemed to accrue or arise in India if they are paid by the *Government*. Such fees payable by a person who is *resident* in India will also be deemed to accrue or arise in India, except in case where the fees are payable in respect of technical services utilised in a business or profession carried on by the person *outside* India or for the purposes of making or earning any income from a source *outside* India. Fees for technical services payable by a *non resident* will, however, be deemed to accrue or arise in India only in cases where the fees are payable in respect of services utilised in a business or profession carried on by the non-resident in India or where such services are utilised for the purpose of making or earning income from a source in India. Income by way of fees for technical services payable in pursuance of an agreement made *before 1st April*, 1976, and approved by the Central Government shall not be deemed to accrue or arise in India under this clause if such income is not deemed to accrue or arise in India under any other provision of the Act. For this purpose, an agreement made on or after the 1st day of April 1976, shall be deemed to have been made before the date if the agreement is made in accordance with the proposal approved by the Central Government before that date.

For the purpose of this clause, the expression 'fees for technical services' (including any lumpsum consideration) means any consideration for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

Illustrations

(1) Mr. Kelvin, a non-resident lent Rs. 5,00,000 to Mr. Singh a resident in India. Mr. Singh used the moneys borrowed for the purpose of the business in

India. Mr. Singh paid an interest of Rs. 75,000 during the year ended 31st March 1983 to Mr. Kelvin in U.K. Discuss the taxability of such interest in the hands of Mr. Kelvin in India. What would have been the position (a) if Mr. Singh had used the borrowed money for the purpose of business situated outside India or (b) if Mr. Singh were a non-resident in India or (c) if Mr. Singh were a non-resident and he had used the borrowed moneys for the purpose of business outside India.

Answer *: Interest paid by a resident in India on moneys used for the purpose of business in India shall be deemed to accrue or arise in India to the recipient by virtue of Sec. 9(1)(v). Hence interest of Rs, 75,000 paid by Mr. Singh to Mr. Kelvin in U.K. will be deemed to accrue or arise to Kelvin in India. Hence Mr. Kelvin would be liable to tax in India in respect of Rs. 75,000 for the assessment year 1983-84.*

The answer would be different in the following manner in cases of (a), (b) and (c) referred to in the question.

Case (a) : If Mr. Singh had used the borrowed moneys for the purpose of business situated outside India, the interest of Rs. 75,000 paid to Mr. Kelvin would not be deemed to accrue to him in India and consequently, Mr. Kelvin, being a non-resident in India, would not be liable to tax in India in respect of interest of Rs. 75,000 which accrued and received outside India.

Case (b) : If Mr. Singh were a non-resident in India and the borrowed moneys were used for the purpose of business situated in India, the interest of Rs. 75,000 paid to Mr. Kelvin shall be deemed to accrue in India by virtue of Sec. 9(1)(v). Hence Mr. Kelvin, though he is a non-resident, would be liable to tax in India in respect of interest of Rs. 75,000 for the assessment year 1983-84.

Case (c) : If Mr. Singh were a non-resident in India and the borrowed moneys were used for the purpose of business situated outside India, the interest of Rs. 75,000 paid to Mr. Kelvin would not be deemed to accrue in India under Sec. 9(1)(iv). As Mr. Kelvin is a non-resident in India and interest of Rs. 75,000 has accrued to and received by him outside India, he would not be liable to tax for the assessment year 1933-84.

(2) Toshio (Japan) Ltd. a non-resident company in India derived royalties from the following sources :

(a) Rs. 50,000 from Government of India.

(b) Rs. 1,50,000 from ABC Co. Ltd. a resident company in India for importing drawing specifications for its business in Calcutta.

(c) Rs. 2,50,000 from DEF Co. Ltd., a resident company in India for importing certain drawings for the purpose of its business in U.K.

(d) Rs. 2,00,000 from Kamalnath a non-resident in India for utilising certain secret formulae for his business in India.

(e) Rs. 1,00,000 from S. Paul, a non-resident in India for using certain drawings for his business in U.K.

Discuss the taxability of the above receipts in the hands of Toshio, Japan, Ltd., assuming that the relevant agreements were entered into by the assessee in 1978.

Answer : Toshio (Japan) Ltd., a non-resident in India would be taxable in India in respect of (a) income accrued or arisen or deemed to accrue or arise in India and (b) income received or deemed to be received in India as per Sec. 5(2). The taxability of the assessee in the case of different items of royalty is discussed in seriatum below :

(a) It shall be deemed to accrue or arise in India under Sec. 9(1)(vi)(a). Hence Toshio (Japan) Ltd. would be taxable in India in respect of Rs. 5,00,000.

(b) It shall be deemed to accrue in India by virtue of Sec. 9(1)(vi)(b) and hence it is taxable in the hands of Toshio (Japan) Ltd.

(c) Royalty of Rs. 2,50,000 would not be deemed to accrue or arise in India as per Sec. 9(1)(vi)(b) and hence, it would not be taxable in the hands of Toshio (Japan) Ltd.

(d) It would be deemed to accrue to Toshio (Japan) Ltd. in India by virtue of Sec. 9(1)(vi)(c). Hence, the royalty of Rs. 2,00,000 would be liable to tax in the hands of the assessee company.

(e) It shall not be deemed to accrue to Toshio (Japan) Ltd. in India under Sec. 9(1)(vi)(c). Hence the assessee-company would not be liable to tax in India in the case of royalty of Rs. 1,00,000.

3. Seiko (Swiss) Ltd., a non-resident company provides technical services to the companies engaged in electronic industry. During the year ended 31st March, 1983, it provided as per the agreements entered into by it in 1977 to five companies and received fees of Rs. 20 lakhs. The other details are as follows :

(a) Fees of Rs. 7,00,000 from Government of U.P. for providing technical consultancy.

(b) Fees of Rs. 2,00,000 from HMT Ltd. a resident in India for provision of managerial consultancy for its project at Bangalore.

(c) Fees of Rs. 5,00,000 from Weston Ltd. a resident in India for provision of technical consultancy for its project in Libya.

(d) Fees of Rs. 3,00,000 from L. P. Ltd. a non-resident in India for providing financial consultancy in connection with its project in Delhi.

(e) Fees of Rs. 3,00,000 from S. P. Ltd. a non-resident in India for providing technical consultancy services in case of its industrial project in Pakistan.

Discuss the taxability of the above receipts in the hands of Seiko (Swiss) Ltd.

Answer : Seiko (Swiss) Ltd. a non-resident company in India would be liable to tax in respect of (a) income received or deemed to be received in India (b) income accrued or arisen or deemed to accrue or arise in India. Provision of technical or

managerial consultancy constitute technical services. Fees for technical services received by Seiko (Swiss) Ltd. from different persons would be treated in the following manner :

(a) It would be deemed to accrue to Seiko (Swiss) Ltd. in India by virtue of Sec. 9(1)(vii)(a). Hence, the assessee would be liable to tax in respect of the fees of Rs. 4,00,000.

(b) It would be deemed to accrue to Seiko (Swiss) Ltd. in India under Sec. 9(1)(vii)(b) and it shall be liable to tax in respect of Rs. 2,00,000 in India.

(c) It shall not be deemed to accrue or arise in India under Sec. 9(1)(vii (b). Hence Seiko (Swiss) Ltd. would not be liable to tax in India in respect of Rs. 5,00,000 received from Weston Ltd.

(d) It shall be deemed to accrue in India by virtue of the provisions of Sec. 9(1)(vii)(c). Hence, Seiko (Swiss) Ltd. would be liable to tax in India in case of fees of Rs. 3,00,000 received from L.P. Ltd.

(e) It would not be deemed to accrue in India under Sec. 9(1)(vii)(c). Hence Seiko (Swiss) Ltd. would not be liable to tax in respect of Rs. 3,00,000 received from S.P. Ltd.

SELF-EXAMINATION QUESTIONS

These questions are intended to enable the student to test his knowledge before proceeding to answer the test paper. Answers to these questions are not required to be written or submitted for evaluation. Answers are given at the end.

1. 'Income' is defined in Section
   (a) 2 (24) (b) 2 (14) (c) 2 (22) (d) 2 (1) (e) 2 (17)

2 Charge of income-tax is based on

   (i) (a) salary income (b) business income (c) total income (d) total world income (e) agricultural income

   (ii) the income of the (a) assessment year (b) calendar year (c) financial year (d) Samwat year (e) previous year

3. The rates of Income-tax are prescribed in

   (a) the Income-tax Act (b) the Income-tax Rules (c) Finance Act

   (d) Government Notification

4. Tax is to be levied on all receipts which are of a

   (a) capital (b) revenue (c) deferred revenue (d) lasting (e) recurring nature.

5. State whether the following are capital or revenue receipts :

(i) Amount representing sale price of property received in instalments.

(ii) Annuity.

(iii) Royalties.

(iv) Share of profits received in consideration of property sold.

(v) Compensation received for abolition of Zamindari rights.

(vi) Interim maintenance allowance paid to Zamindars before payment of compensation.

(vii) Compensation received for nationalisation.

(viii) Compensation for compulsory acquisition of land.

(ix) Compensation for compulsory vacation of place of business, disturbance and loss of business.

(x) Compensation for estate allotted to coparceners on partition acquired by the Government.

(xi) Compensation for suspension of export licence.

(xii) Lumpsum consideration received for transfer of the entire business including stock-in-trade.

(xiii) Money received on maturity of Life Insurance Policy.

(xiv) Money realised on sale of investments in shares.

(xv) Dividends and interest from investments.

(xvi) Sale proceeds of shares held by a dealer in shares.

(xvii) Premium on issue of shares.

(xviii) Discount on redemption of debentures.

(xix) Unclaimed dividends.

(xx) Unclaimed wages.

(xxi) Bonus shares received by a dealer in shares.

(xxii) Compensation for termination of agency (a) where there is only one agency or (b) where there are many agencies one of which is terminated.

(xxiii) Compensation for termination of employment.

(xxiv) Profit on devaluation of foreign currency.

(xxv) Properties including stock-in-trade received by a member on partition of a H.U.F.

(xxvi) Money received on sale of trees.

(xxvii) Compensation received for restraint of trade.

(xxviii) Annual allowance received by a married daughter in lieu of dowry according to custom.

(xxix) Sales tax collection from purchasers of goods.

6. The incidence of taxation depends upon :

(a) residential status (b) citizenship (c) age (d) sex (e) religion of the assessee.

7. Income derived in India is taxable in the case of (a) citizens only (b) foreigners (c) all assessees (d) non-residents (e) not ordinarily residents.

8. An Indian citizen who is serving outside India and comes on a vist to India in previous year can remain a non-resident if his stay in that year does not exceed (a) 60 days (b) 90 days (c) 182 days.

9. In the case of (i) a firm and (ii) a company, the control and management of the affairs of which is situated partly in India and partly in Japan the residential status would be that of a –

   (a) non-resident (b) not ordinarily resident (c) resident.

10. The residential status of a non-Indian company would be (a) non-resident (b) resident (c) not ordinarily resident (d) dependent upon the place from which the control and management of its affairs is exercised.

11. The various items of income which are (i) deemed to accrue or arise in India (ii) deemed to be received in India are specified in Section :
(a) 4 (b) 9 (c) 5 (d) 6 (e) 7.

12. When the operations of a non-resident's business are partly in India and partly outside, the liability to tax in India would be on—

   (a) the entire income,
   (b) the sale proceeds in India,
   (c) foreign income,
   (d) the income deemed to accrue in India after appointment of such income under Rule 10 of the Income-tax Rules.

13. Rent received by Mr. A in London from the tenant of his house property in Calcutta is an income accrued :

   (a) outside India
   (b) in India

14. Salary received by Mr. Pradhan from a firm in Rome and remitted to his savings account in State Bank of India at Jaipur is an income accrued :

   (a) in India
   (b) outside India

15. Dividends received by Mr. Chappel in New York from TELCO shall be treated under the Act as income accrued :

   (a) in India
   (b) in U.S.A.

16. Salary received in Paris by Mr. Arun an IFS officer from the Government of India is an income accrued :

   (a) in India
   (b) outside India

17. Mr. Botham a non-resident purchased goods in India and exported them to Canada by which he earned a profit of Rs. 2 lakhs. Is there any deemed income under the Act in the above transaction to Mr. Botham ?

(a) Yes (b) No

ANSWERS

1. (a), 2. (i) (c), (ii) e, 3. (c), 4. (b) 5. (i) capital (ii) revenue, (iii) revenue, (iv) revenue, (v) capital, (vi) revenue, (vii) capital, (viii) capital, (ix) revenue, (x) capital, (xi) capital, (xii) capital, (xiii) capital, (xiv) capital, (xv) revenue, (xvi) revenue, (xvii) capital, (xviii) capital, (xix) capital, (xx) revenue, (xxi) capital, unless the conduct of the assessee shows that he has converted them into stock-in-trade, (xxii) (a) capital, (b) revenue, (xxiii) revenue, (xxiv) capital or revenue depending upon the circumstances, (xxv) capital, (xxvi) capital or revenue depending upon how the know-how was kept by the seller prior to the sale, (xxvii) capital, (xxviii) capital, (xxix) revenue, 6 (a), 7. (c), 8. (b), 9. (i) (c), (ii) (a), 10. (d) 11. (i) (b), (ii) (e) 12. (d), 13. (b), 14. (b), 15. (a), 16. (a), 17. (b).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL I.S.P. (N) I. Tax—3

INTERMEDIATE COURSE (N)

ELEMENTS OF INCOME-TAX LAW

STUDY—III

'his *Study Covers* :

I. EXCLUSIONS FROM TOTAL INCOME

II. EXEMPTION OF INCOME OF CHARITABLE OR RELIGIOUS TRUSTS OR INSTITUTIONS

III. INCOME OF POLITICAL PARTIES

'rescribed Readings : *Sukumar Bhattacharya's* Indian Income-tax Law and Practice—Chapters VI & VII.

Dr. H.C. Mehrotra's Income-tax Law and Accounts—Chapter IV.

1. **Introduction** : In this Study Paper, we will be covering the provisions of Section 10 which enumerates the various items of income that are exempt from tax. In addition, we will also be considering briefly Sections 11 to 13A which deal with exemption in respect of income from property held for charitable or religious purposes and income of political parties. Let us start with Section 10.

2. **Exclusion from total income** (Section 10) : The various items of income referred to in the different clauses of Section 10 are not only excluded from the taxable income of an assessee but also from his total income. Consequently such income excepting agricultural income, is to be wholly disregarded and shall not enter into the computation at all either for determining the taxable income or the rate of tax. An assessee can enjoy exemption under this section in respect of the specified categories of income even if the income is in reality not his income but is deemed to be his income by virtue of any provision of the Act (e.g. Sections 60 to 64). In the case of some of these exemptions, the factor determining the eligibility for exemption is the nature or the class of income. In other cases, it is the character of the aesessee which determines his eligibility for the exemptions. However, the onus of showing that a particular item of income falls within any of the clauses of this Section is on the assessee. In addition to the various items listed in this Section, certain other incomes are also wholly or partly rendered tax-free by being allowed as deductions in computation of total income under Sections 80H to 80U. Let us now see the various incomes that are exempt from tax and the conditions to be satisfied in order to be eligible for exemptions

2.1 **Argicultural income** [Section 10 (1)] : Perhaps you would remember that in the context of our discussion on the definition of 'agricultural income' in Study Paper I we have noted that agricultural income is not to be included in the total income of the assessee. We have also noted that with effect from 1-4-1978, in the case of certain non corporate taxpayers (*i.e.*, individuals, Hindu undivided families, unregistered firms, associations of persons or bodies of individuals and artificial juridical persons) whose non-agricultural income exceeds the minimum exemption limit (Rs. 15,000 with effect from the assessment year 1982-83) both the agricultural and non-agricultural components of their income should be aggregated for purposes of determining the rate of income tax that will apply to the non-agricultural portion. Any receipt from lands which falls within the meaning of the expression 'agricultural income' as defined in Section 2 (1) is exempt from tax.

2.2 **Amounts received by a member from the income of the Hindu undivided family** [Section 10 (2)] : As seen in Study Paper I, a Hindu undivided family is a 'person' and hence a unit of assessment under the Act. Income earned by the Hindu undivided family is assessable in its own hands. In order to prevent double taxation of one and the same income, once in the hands of the Hindu undivided family which earns it and again in the hands of a member when it is paid out to him Section 10(2) provides that members of a Hindu undivided family do not have to pay tax in respect of amounts received by them from the family. The exemption applies only in respect of a payment made by the Hindu undivided family to its member (i) out of the income

of the family or (ii) out of the income of the impartible estate belonging to the family. Exemption under this clause cannot be denied to the assessee on the ground that (1) payment is made under a will, an agreement or a deed or (2) the member is living apart from other members of such family or (3) the family or the impartible estate has not paid the tax on the income of which the payment is made. However, the exemption cannot be claimed in respect of the payments made by HUF. In a nutshell to claim the exemption, the assessee should be a coparcener and the nature, frequency and purpose of the payments are immaterial for this purpose. It should be noted that this exemption is subject to the provisions of Section 64(2), which we shall consider at a later stage.

2.3 **Casual and non-recurring receipts** [Section 10(3)]: In computing the total income of a previous year, any receipts which are of a *casual and non-recurring* nature (other than lottery winnings for which special provision is made) shall not be included to the extent such receipts do not exceed one thousand rupees in the aggregate. The following items of income are not treated as casual income:

(i) capital gains, chargeable under Section 45 ; or

(ii) receipts arising from business or the exercise of a profession or occupation; or

(iii) receipts by way of addition to the remuneration of an employee.

The exemption would be available only if the receipt in addition to its being of a revenue nature is *both* casual and non recurring. It is the nature of the receipt that is to be the guiding factor. Casual income falling under any of the three categories referred to above are taxable irrespective of their quantum. Students should refer to the prescribed books for a detailed commentary on the concept of casual and non-recurring incomes.

It is to be noted that the present Section 10(3) was substituted by the Finance Act, 1972. Prior to this substitution, total exemption was available in respect of this type of receipts. The effects of the amendments made by the Finance Act, 1972, in so far they relate to this exemption are briefly discussed hereunder :

(i) The definition of 'income' under the Act is extended to specifically cover winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever. Thus, though these categories of receipts are in the nature of casual and non-recurring incomes, they are now chargeable as 'income' under the Act. We have already seen the scope of the term 'income' in Study Paper II.

(ii) Winnings from State or other lotteries in the case of non-corporate tax payers will be taxed on a concessional basis in accordance with the provisions of Section 80TT.

(iii) Other casual and non-recurring receipts which are in the nature of 'income' and in excess of Rs. 1,000 in a year will be included in the total income in

the case of all categories of assessees and charged to tax at normal rates The exemption of the first Rs 1,000 of income will, however, not be available in respect of capital gains, receipts arising from business or the exercise of a profession, vocation or occupation or receipts by way of any addition to the remuneration of an employee and such incomes will continue to be chargeable to tax as on the earlier basis.

(iv) Special provisions have also been made dealing with the mode of chargeability of such casual income and treatment of losses from such sources. We will be discussing these provisions also at their appropriate places.

Both before and after the amendments by the Finance Act, 1972 receipts which constitue capital gains or which arise from a business or the exercise of profession, vocation or occupation or by way of additions to the remuneration of an employee are not exempt under Section 10(3). Since capital gains fall within the net of taxation such receipts have been specially excluded from the scope of casual receipts. Similarly, receipts arising from business or the exercise of profession or occupation even if they are of a casual or non-recurring nature, shall not enjoy exemption and shall be included in the total income. Thus, even a casual receipt arising from trade or from an adventure in the nature of trade would be regarded as income assessable to tax. The test for determining whether casual and non-recurring receipts are mere gifts or windfalls which are not income or income from the profession or vocation of the assessee, is whether the payment is connected with the exercise of the assessee's profession or vocation and secondly, if it is so connected, whether it is made merely in appreciation of the personal qualities of assessee displayed in the course of his engagement or is intended to confer a special benefit on him with respect to the service rendered so as to increase his earnings in the exercise of his profession. Thus commission received by a practising architect for the negotiation, on only one occasion, of the sale of an estate, customary offering made to the head of a religious body by his devotees, gifts by disciples to their guru who teaches devotional and spiritual philosophy, bonus voluntarily paid by a textile association to the assessee who carries on textile business, tips to taxi drivers given in the ordinary way, gifts of moneys over and above the full professional fees and gifts received from third party who is not a client would not be exempt under this clause though they may be casual and non-recurring in nature. Annual or unusual increments of allowances received from the employer (whether due to the employees under the terms of employment or not), which go to increase the salary of the assessee would not be covered by the exemption under this Section and hence would be taxable as income from salaries. However, prizes, gifts or other presents given by the employer in recognition of the meritorious services of an employee which do not go to increase his salary would fall under this clause as they would be receipts of a casual and non-recurring nature. And any gift which is personal in the sense that is given to the person not as a holder of office or employment, but as a personal testimonial or as a token of personal esteem and veneration (regard of deep respect), or to mark an occasion (like wedding) is not income.

It is to be noted that the Income-tax Act imposes a general liability to tax upon all *income* subject to specific exemptions. Act does not provide anywhere that

whatever is received by a person must be regarded as income liable to tax. In view of this position casual and non recurring receipts which are not in the nature of *income* or which do not fall within the scope of the definition of the term income are outside the purview of the Income tax Act. Consequently the question of applying the exemption under Section 10(3) to such receipts does not arise

Students should refer to the various illustrations given in the recommended text-books.

***2.4 Interest received by a non resident** [Sections 10(4), (4A) and 4(B)]* : Income *from interest on or from the premium on redemption of* any bonds issued by (1) the Central Government under a loan agreement with International Bank for Reconstruction and Development or with the Development Loan Fund of U.S.A. or (2) any industrial undertaking or financial corporation in India under a loan agreement with the said bank or fund as the case may be, which is guaranteed by the Central Government.

In addition, the non-residents are also exempt from tax in respect of income from interest on such securities as the Central Government may, by notification in the Official Gazette, specify in this behalf. So far, the following securities have been notified in this regard :

1. 4½ per cent National Defence Loan, 1968.
2. 4¾ per cent National Defence Loan, 1972.

2.5 Balance in Non-resident (External Account)

Under the provisions of Section 10(4A) exemption would be available in respect of interest on moneys standing to the credit of 'person resident outside India,' in a Non-resident (External) Account in any Bank in accordance with the Foreign Exchange Regulation Act, 1974 and any rules made thereunder.

For this purpose the term "person resident outside India" shall have the meaning assigned to it in Clause (q) of Section 2 of the Foreign Exchange Regulation Act 1973 Such a person may or may not be a non-resident under the Income tax Act.

2.6 Interest on Saving Certificates : A new Clause (4B) has been inserted in Section 10 with effect from 1st April, 1983. Accordingly an individual, being citizen of India or a person of Indian origin, who is a non-resident shall be entitled for exemption in respect of interest on such savings certificates issued by the Central Government and notified by it in the Official Gazette specifying in this behalf The Government has notified National Savings Certificates VI & VII issues for this purpose. However, to claim such exemption, the individual should have subscribed to such certificates in foreign currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exehange Regulation Act, 1973. The Explanation to the Clause (4B) states that (a) a person shall be deemed to be of Indian origin if he or either of his parents or any of his grand parents, was born in undivided India, and (b) "foreign

currency" and "*foreign exchange*" have the meanings respectively assigned to them in the Foreign Exchange Regulation Act, 1973.

2.7 **Passage money and leave travel allowances** *[Section 10(5) and 10(6)(i)]*: *An employee who is a citizen of India is exempt from tax in respect of the value of any* travel concession or assistance *for himself and his family (i.e., his spouse and children* of the individual, parents, brothers & sisters *of the individual or any of them, wholly or mainly dependent on the individual) in connection with his proceeding on leave to* his home district in India after retirement from or termination of his service. The employee would be eligible for this exemption even in respect of the value of any travel concession in connection with his proceeding with his family to any place in India. However, in such cases the exemption would be restricted to the value of the concession which would have been available if he had travelled to his home district. It is to be noted that the Central Board of Direct Taxes is empowered to prescribe (having regard to the travel concession of assistance granted to the employees of the Central Government) in the Income tax Rules, exceptions to the condition that the exemption from Income-tax in respect of travel concession or assistance will be limited to the amount that would have been due to the assessee had he proceeded on leave or after retirement from service or after the termination of his service, to home district in India. The circumstances in which the amount exempt under Section 10(5)(ii)(a) in respect of the value of travel concession or assistance received by or due to the individual from his employer for himself and his family, in connection with his proceeding on leave to any place in India, may exceed the value of the travel concession or the assistance which would have been received by or due to him in connection with his proceeding to his home district in India on leave are specified in Rule 2B. This rule has been framed having regard to the travel concession or assistance available to the employees of Central Government or other organisation, under which the employee is entitled to travel free of cost on leave to any place in India with his family once in a block of every four years.

In the case of any employee who is not a citizen of India, Section 10(6)(i)(a) provides for an exemption in respect of passage moneys for himself and his spouse and children in connection with his proceeding on leave out of India or in connection with his proceeding to his home country out of India after retirement or termination of his service. Passage moneys or the value of any free or concessional passage received by a foreign employee from his employer to meet the cost of travel of his children having full-time education in any educational institution outside India in connection with their proceeding to India during vacation will also be exempt under Section 10(6)(i)(aa). Exemption under this provision will be available not only in respect of passage moneys or the value of free or concessional passage for the journey to India, but would also extend in respect of the passage money for the journey back to the foreign country in which the children of the individual are having full-time education.

It is to be noted that in both the cases the exemption would be available to

2.8 Other items of remuneration payable to non-citizens of India [Section 10(6)] : Individual assessees who are not citizens of India are entitled to several exemptions under Section 10(6). We have already considered in the preceding paragraph the exemption under-Section *10(6)(i) in respect of passage money and leave allowances. Sub-clauses (ii) to (v) grant exemptions to such an assessee in respect of the remuneration received by him for services : -*

(*i*) as ambassador, high commissioner, envoy, minister, charge d'affaires, commissioner, counsellor or the secretary, adviser, etc., of foreign State.

(*ii*) as *counsel de carriere* of foreign State;

(*iii*) as a trade commissioner or other official representative in India of a foreign State on reciprocal basis;

(iv) as a member of the staff of any of the officers mentioned in (i) (ii) and (iii) above, if he is a subject of that country and is not engaged in any other business, profession, or employment in India. In the case of persons falling under (iii) and (iv) above the exemption would be available only on a reciprocal basis.

(v) Remuneration received by a foreign national as an employee of a foreign enterprise for services rendered by him during his stay in India is also exempt from tax provided (a) the foreign enterprise is not engaged in a business activity in India; (b) the employee's stay in India does not exceed a total of 90 days in the previous year; (c) the remuneration is not liable to be deducted from the employer's income chargeable to tax under the Act. Section 10(6) (vi) provides for this exemption.

(vi) Remuneration received by a non-Indian citizen, who is either an employee or a consultant to an approved foreign association or institution or a body established solely for philanthropic purpose, for services rendered in India for a purpose which has been approved by the Central Government

(vii) **Foreign technicians** [Section 10(6) (vii) and (viia)]: Foreign technicians who qualify for exemption in respect of their remuneration can be broadly classified into categories :—

(1) Technicians whose employment commenced from a date before 1-4-1971, and

(2) Technicians who have taken up employment in India on or after April 1, 1971.

The former category is governed by sub-clause (vii) of Section 10(6) while the latter is governed by sub-clause (viia). For the purposes of the *first* category the term 'technician' means a person having specialised knowledge and experience (i) in industrial or business management techniques; and (ii) in construction or manufacturing operations, or in mining or in the generation or distribution of electricity or any other form of power. However for the purposes of the *second* category, the term 'technician' (i) *excludes* from its scope persons having specialised knowledge and experience in industrial or business management techniques and *distribution* of electricity or any other form of power, and (ii) *includes* persons with specialised knowledge and experi-

ence in agriculture, animal husbandry, dairy farming (but not poultry farming), deep-sea fishing and ship building. In other words, for purposes of the second category a 'technician' means a person having specialised knowledge and experience in constructional or manufacturing operations or in mining or in the generation of electricity or any other form of power or agriculture, animal husbandry, dairy farming, deep-sea fishing or ship building.

The Central Government has also been empowered to specify by notification in the Official Gazette any other field in which the foreign technician can be employed in India having regard to the availability of Indian technicians in that field, the needs of the country and other relevant circumstances In the case of both the above categories besides having the necessary knowledge and experience the technician should be employed in India in a capacity in which such specialised knowledge and expertence are actually utilised. Similarly, in both the above cases, the exemption would be available only if the technician is *not* a citizen of India and was *not* resident in India in any of the four financial years immediately preceding the financial year in which he arrived in India. However, it is to be noted that in the case of the second category of technicians the Central Government is empowered to waive the condition regarding the residential status during the said four preceding financial years where the technicians are employed in India for designing, erectioning or commissioning of machinery or plant or supervising activities connected therewith if it considers it necessary or expedient to do so in public interest. Again the exemption would be available in both the above cases to technicians employed by the Government or local authority or any corporation set under any special law or in any business carried on in India. In addition, in the case of the second category, even those technicians who are employed by any such institution or body established in India for carrying on scientific research as is approved for the purpose by the prescribed authority would be eligible for this exemption

It should be carefully noted that the requirements regarding the approval of the contract of service of the technician by the Central Government are not similar in the two cases In the case of the first category technicians whose employment has commenced from a date before April 1, 1971, the contract of service should have been approved by the Central Government before the date of commencement of the service of the technician or within one year from that day In the case of technicians having specialised knowledge and expertise in industrial or business management, this approval *must* be obtained if the exemption is to be enjoyed. In the case of other technicians though the approval of the contracts by the Government is not a condition precedent for the enjoyment of exemption the non approval will affect the period of exemption.

In the case of second category (technicians whose service commence on or after 1-4-1971) the contract of service in India *should* be approved by the Central Government in *all* cases. The application for such approval should be made to the Government before the date of commencement of service or within six months from that date.

Let us now see the quantum and the period of exemption. The provisions concerning technicians whose employment commenced prior to 1-4-1971 have got only

academic importance now and hence have not been considered here. The provisions relevant to technicians whose services commence on or after 1-4-1971 are presented here in a tabular form.

Type of Technician	Quantum and period of exemption
Technicians whose services commenced on or after 1-4-1971	Remuneration due to or received by a technician upto a maximum of Rs. 4,000 per month of a period of twenty-four months commencing from the date of his arrival in India. If, however, the technician's salary exceeds Rs 4,000 per month and his employer pays tax on the excess of the salary over Rs. 4.000 per month for the said twenty-four months period the tax element so paid will also enjoy exemption which, would otherwise, have been includible in the technician's salary as perquisite for the purposes of tax levy. Again it may be noted that this is an exception to the rule prohibiting payment of tax-free salary, as embodied in Section 200 of the Companies Act. In case such technician continues in employment in India after the expiry of the said twenty-four months period, with the approval of the Central Government obtained before 1st October of the relevant assessment year and the tax on his remuneration is paid to the Government by his employer, the amount of tax so paid shall not be charged to tax for further period of another twenty-four months next following. Consequently, if the technician continues to stay in India even after the expiry of forty-eight months from the date of his arrival in India, there would be no exemption from tax on his remuneration and if the tax on remuneration is paid by the employer the tax so paid will also be taxed as a perquisite.

It is to be remembered that in the above cases, the exemption from tax available to a technician is only in respect of his income by way of remuneration for such services in India due to or received by him which is chargeable to tax under the head 'salaries' but not to his other income, if any.

*(viii) **Salary of non-residents on board a foreign ship** [Section 10(6)(viii)] : B*
*foreign technicians, exemption has also been granted in respect of **salary income re***
*ved by or due to a non-citizen of India who is also non resident **for services rende***
in connection with his employment on a foreign ship where his total stay in Ind
does not exceed a total of 90 days in the previous year

(ix) Salary income of a foreign teacher *[Section 10(6)(ix)] : Non Indian citizen*
individuals who have also not been residents in India any of the four financial years
immediately preceding the financial year of their arrival in India would be exempt from tax on their income from salaries in respect of services rendered by them in India in the capacity of a professor or teacher in a university or other educational institutions in India The exemption would be available only if their contract of service had been approved by the Central Government prior to or within one year from the date of commencement of their service in India. The exemption extends to the salary for a period of 36 months commencing from the date of arrival in India. If the service continued beyond such tax-free period of 36 months and the employer pays tax on his salary income the amount of tax so paid shall enjoy exemption for a further period of 24 months and not be includible in his total income as a perquisite.

(x) Income from research work [Section 10(6)(x)] : Any sum due to or received by individuals who are not citizens of India for undertaking any research work in India during the period of 24 months from the date of individual's arrival in India is exempt from tax, if,

(a) the research work is undertaken in connection with a research scheme approved by the Central Government in this behalf on or before 1st October of the relevant assessment year; and

(b) Such income is payable to the individual directly or indirectly by the Government of a foreign State or any institution or association or other body established outside India.

(xi) **Remuneration received by foreign trainees in Government establishments, etc.** [Section (10)(6)(xi)] : Any remuneration received by employees of foreign Governments from their respective Governments during their stay in India in connection with their training in any establishment or office of the Government or any public sector undertaking is exempt from tax. For this purpose, the expression public sector undertaking will cover Statutory Corporations; companies wholly owned by the Central Government or State Governments or jointly by the Central and State Governments and subsidiaries of such companies, Societies registered under the Societies Registration Act, 1860 or any other similar law, which are wholly financed by the Central Government or State Government or jointly by the Central and State Governments.

2.9 Tax on Royalty or Fees for Technical Services derived by Foreign Companies [Section 10(6A)] ; The new clause (6A) has been inserted by the Finance Act 1983 with effect from the assessment year 1984-85. The benefit of exemption conferred under this clause is available to foreign campanies only. As per this clause, tax paid by the Government or by an Indian concern on behalf of a foreign company is exempt

in the hands of such foreign company provided that all the following conditions are satisfied.

(i) Such tax must have been payable by the foreign company in respect of income received from the Government or the Indian concern by way of royalty or fees for technical services.

(ii) Such income by way of royalty or fees for technical services must have been received in pursuance of an agreement made by the foreign company with the Government or the Indian concern on or after 1st April 1976 and such agreement must have been approved by the Central Government.

For the purposes of this clause the following terms shall have the meanings assigned to them hereunder.

(a) 'Fees for technical services' shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of Section 9 (refer to the discussion thereon, in Study 2).

(b) 'Foreign company' shall have the same meaning as in Section 80B—(refer to the discussion thereon in Study 1)

(c) 'Royalty' shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of Section 9 (refer to the discussion thereon in Study 2).

2.10 **Allowances payable outside India** [Section 10(7) ; Allowances or perquisites paid or allowed as such *outside* India by the *Government* to a *citizen* of India for services rendered *outside* India are exempt from tax Students may remember that in such cases under Section 9(1)(iii) the income chargeable under the head 'salaries' is deemed to accrue in India. The residential status of the recipient will not affect this exemption.

2.11 **Co-operative technical assistance programmes** [Section 10(8) and (9)]. Individuals who are assigned duties in India in connection with any co-operative technical assistance programmes and projects would be exempt from tax on their receipts by way of :

(a) remuneration received directly or indirectly from the Government of foreign State for rendering such services ; and

(b) any other income accruing or arising outside India (but is not deemed to accrue or arise in India) in respect of which the individual is required to pay income-tax or other social security tax to the Government of that foreign State.

The exemption would be available only if all the following conditions are satisfied :

(i) The co-operative technical assistance programme and projects in connection with which the individual gets income, should be in accordance with an agreement entered into by the Central Government with the Government of a foreign State ; (ii) the terms of agreement should provide for this exemption ; (iii) the income should

be payable to the assessee on account of his services in that foreign country in connection with the programmes or projects ; (iv) the income should not be deemed to accrue or arise in India under Section 9 ; (v) the income in respect of which this exemption is granted should be payable by the foreign Government and should be subject to income or security tax in that country

The above exemption would be available irrespective of the fact whether or not the individual is a resident or citizen of India and whether the amount in question has been actually received by him or not.

A similar exemption would be available under Section 10(9) in respect of the income of any member of the family of any such individual referred to above provided that the income ; (i) actually accrues outside India ; (ii) cannot be deemed to accrue or arise in India ; and (iii) in respect of which such member is required to pay income or social security tax to the Government of that foreign State

2.12 **Gratuity** [Section 10(10)] : The following types of gratuities qualify for tax exemption *without* any ceiling limit :

(i) Death-cum-retirement gratuity received by all categories of Central Government employees, as also employees of State Government or local authorities or under any similar scheme of State Government, or a local authority.

(ii) Retirement gratuity received under the Pension Code regulations applicable to members of the Defence Services.

(iii) Gratuity received under Section 4(2) and (3) of the Payment of Gratuity Act, 1972.

In the case of any other gratuities received by employees of statutory corporation and employees in the private sector, who are not covered by the payment of Gratuity Act, 1972, the exemption will be available if such gratuities are received on retirement, incapacitation or death of the employee or on termination of his employment. In such cases, the exempt amount of gratuities will be subject to a ceiling limit of one-half month's salary for each year of completed service calculated on the basis of the average salary for the three years immediately preceding the year in which the gratuity is paid or 20 months' salary so calculated or Rs. 36,000 whichever is less.

It is also specifically provided that even in cases where a person works successively or simultaneously with more than one employer the aggregate amount of gratuity exempt from income tax cannot exceed Rs. 36,000 Thus, where gratuity is received by the employee from two or more employers in the same year, the maximum amount of gratuity exempt from income-tax will not exceed Rs. 36,000. In cases, where an employee who has received gratuity in any earlier year from his former employers, receives gratuity from another employer in the latter year, the ceiling limit of Rs. 36,000 will be reduced by the amount of gratuity which has been exempted in any earlier year.

It may be noted that the monetary ceiling limit applicable to cases where the event on which gratuity is received had occurred before 31st January 1982 is Rs. 30,000.

Where the gratuity received exceeds the amount exempt, the excess over the exempted amount shall be taxable as income of the assessee from salaries. The term 'salary' for this purpose includes dearness allowance, if the terms of employment so provide, but excludes allowances and perquisities. The amount of gratuity exempt will not be included in the total income

It is to be noted that the exemption in respect of gratuities would be available even if the gratuity is received by the widow, children or dependents of a deceased employee.

Illustration :

Q. Mr. P. received a gratuity of Rs. 20,000 from ABC Pvt. Ltd. on this retirement on 31st December, 1983 after 15 years of service. Determine the taxable amount of gratuity (A) if he did not receive gratuity from any other employer or in any earlier year (B) if he received gratuity of Rs. 20,000 from his previous employer, of which he availed an exemption of Rs. 10,000 (C) if he received gratuity of Rs. 20,000 and it was totally exempt. Assume that salary for years 1980, 1981, 1982 and 1983 was Rs. 1,900, Rs. 2000, Rs. 2,100 and 2,200 per month respectively.

Ans. Gratuity received by Mr. P. from his employer constitutes an income chargeable to tax as a part of salary u/s 15 subject to the amount of exemption eligible under Section 10(10). Since Mr. P. is an employee in Private Sector the provisions of Section 10(10) (iii) shall be applicable for exemption. The taxable amount of gratuity is worked out below :—

A. If Mr. P. did not receive gratuity previously least of the following.

(i) Average monthly salary [the average of salary in three calendar years preceding to the year of retirement = Rs. 2,000 $\frac{(1900+2000+2100)}{3}$

1/2 month's salary for 15 completed years of service Rs. 15,000

(ii) 20 months average salary 20 × 2,000 = 40,000

(iii) Rs. 36,000.

(iv) actual amount Rs. 20,000.

So the exemption u/s 10(10) (iii) shall be Rs. 15,000 being the least of them Hence amount of Rs. 5,000 is taxable as part of salary u/s 15.

B. If Mr. P. received gratuity of Rs. 20,000 from previous employer and he got an exemption of Rs. 10,000 the exemption available to him now shall be Rs. 15,000 as it is the lowest of the four figures viz. Rs. 15,000, Rs. 40,000, Rs 20,000 and Rs. 26,000 (the ceiling limit of Rs. 36,000 as reduced by Rs. 10,000 being the amount of exemption enjoyed by the assessee on earlier occasion). Hence the taxable amount of gratuity in Mr P's hands shall be Rs 5,000.

C. In case Mr. P received gratuity of Rs. 20,000 from his previous employer and he claimed exemption of entire amount, then the exemption now available would be Rs. 15,000 as it is lowest of the four figures viz; Rs. 15,000 Rs. 40,000, Rs. 20,000 and Rs. 16,000 (ceiling limit of Rs. 36,000 as reduced by Rs. 20,000 being the amount

of exemption availed under Section 10(10) on earlier occasion) ***Hence Mr. I***
be liable to tax in respect of Rs. 5,000 of the gratuity ***he received.***

2.13 Payment in commutation of pension *[Section 10(10A)]* : ***Any paym***
commutation of pension received under the appropriate rules of ***schemes*** *appli*
commutation of pension received under the Central or State Governments, local ***authorities or Statu***
to all employees of the Central or State Governments, local authorities or Statu
Corporations or members of the Defence Services would be totally excluded in
computation of total income and consequently would be ***exempt from tax in full.***

Exemption is also available in respect of similar payment from private employe in commutation of pension but exemption in respect of any such **amount received on or after August 19, 1965 from a private employer** is subject to certain limits, viz., in cases where the employee also gets a gratuity, the commuted value of one-third of pension, and in any other case the commuted value of one-half of such pension. The exemption in such cases shall have application only within the above limits.

2.14 Exemption of Amount Received by way of Encashment of Unutilised Earned Leave on Retirement : (Clause 10AA) : A new Clause (10AA) has been inserted in Section 10 by the Finance Act, 1982 with retrospective effect from 1st April 1978. It provides exemption in respect of amount received by way of encashment of unutilised earned leave by an employee at the time of his *retirement* on *superannuation* or *otherwise*. The provisions of this Clause are mentioned below.

(1) Employees of the Central Government or a State Government shall not be liable to tax in respect of *any amount* received by them by way of encashment of earned leave at the time of their retirement on superannuation or otherwise.

(2) In case of employees, not being employees of the Central Government or a State Government, retired before 1st January 1982 the amount of exemption under this Clause shall be restricted to the lower of the following :

  (a) Cash equivalent of earned leave at the credit of employee not exceeding six months as calculated on the basis of average salary

  (b) Rs. 25,500

(3) In case of employees, not being employees of the Central Government or a State Government retired on or after 1st January, 1982 the amount of exemption shall be the lower of the following :

  (a) Cash equivalent of earned leave at the credit of employee not exceeding six months as calculated on the basis of average salary

  (b) Rs. 30,000

For the purposes of (2) and (3) above

(i) 'Average salary' will be determined on the basis of the salary drawn during the period of ten months immediately preceding his retirement on superannuation or otherwise.

(ii) The entitlement to earned leave shall not exceed thirty days for every year of actual service rendered by him as an employee of the employer from whose service he has retired.

(iii) The term 'salary' includes dearness allowance, if the terms of employment so provide but excludes all other allowances and perquisites

Illustrations

1. Mr. Gopal, a Deputy Secretary in the Government of India, retired on 20th January 1983. On retirement he received an amount of Rs. 15,000 by way of encashment of unutilised earned leave to his credit. Discuss the tax liability of Mr. Gopal in respect of this receipt.

Answer

Mr. Gopal an employee of the Central Government will not be liable to tax in respect of the amount of Rs. 15,000 received by way of encashment of unutilised earned leave to his credit at the time of his retirement on superannuation as it is totally exempt under Section 10(10AA).

2. (a) Mr Ravi, General Manager in Weston Electronics Pvt. Ltd. retired on 20th December, 1982 after serving for 10 years. On retirement he received *inter alia* an amount of Rs. 28,000 by way of encashment of earned leave of 7 months to his credit. He drew salary of Rs. 5,000 p m. (inclusive of allownances and perquisites of Rs. 1,000) during 1982. Discuss tax liability of Mr. Ravi in this respect.

Answer

Mr. Ravi is not an employee of either the Central Government or any State Government. He is employed in private sector. He can claim exemption under Section 10(10AA) (ii). The amount of exemption would be lower of the following two:

(1) Salary (excluding allowances and perquisites) for 6 months (earned leave for a period of 7 months is to be restricted to 6 months). 'Salary' here means average salary drawn during 10 months preceding retirement i.e. Rs. 4,000; (Rs $4000 \times 6 =$ Rs. 24,000.)

(2) Monetary limit of Rs. 30,000. Hence Mr. Ravi can claim an exemption of Rs. 24,000 only under Section 10(10AA). He will be liable to tax in respect of Rs. 4,000 as forming part of his salary.

(b) What would have been the position if in 2 (a) Mr. Ravi had served the Weston Electronics Pvt. Ltd. for 5 years only and the Company had granted earned leave of 2 months for each year of service and the remaining facts are the same.

Answer

The amount of exemption would be lower of (i) one month's salary for each year of service i e., Rs, 20,000 (Rs. 4000×5) as earned leave of one month only for each year of service should be taken (ii) Rs. 30,000.

Mr. Ravi would get an exemption of Rs. 20,000 under Section 10(10AA) and he would be liable to tax on the amount of Rs. 8,000.

2.15 Retrenchment compensation [Section 10(10B)]. *Retrenchment c... will be exempt from tax subject to the following limits :*

(a) *Amount calculated in accordance with the provisions of Section ... Industrial Disputes Act, 1947,* or

(b) *Rs. 20,000.*

Whichever of the above two amounts is less

The retrenchment compensation for this purpose means compensation under the Industrial Disputes Act, 1947 or under any Act, Rule, Order or Notification issued under any law. It also includes compensation paid on transfer of employ... under Section 25FF or closing down of an undertaking under Section 25FFF of Industrial Disputes Act, 1947.

2.16 Payment from provident funds *[Section 10(11) and (12)]* : Any payme... received by an assessee from a provident fund :

(a) to which the Provident Fund Act, 1925, applies ; or

(b) Set up by the Central Government and notified by it in that behalf as in the case of Public Provident Fund set up by the Central Government under the Public Provident Fund Act, 1968, would be entirely excluded from the total income. Similarly, the amount representing the accumulated balance due and becoming payable to an employee participating in a Recognised Provident Fund would be exempt from tax subject to the conditions specified in Rule 8 of Part A of the Fourth Schedule to the Act The conditions are as follows :

(a) The employee should have rendered continuous service with the employer from whom the amount is received for a period of at least five years ; or

(b) Where the employee had not rendered such continuous service the reason for the termination of his service should have been his ill-health or contraction or discontinuance of employer's business or any other cause beyond the control of the employee.

2.17 Payment from superannuation funds [Section 10(13)] : Any payment received by an employee from an approved superannuation fund shall be entirely excluded from his total income if the payment is made (a) on the death of a beneficiary; (b) to an employee in lieu or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement ; or (c) by way of refund of contribution on the death of a beneficiary : or (d) by way of contributions to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or his becoming incapacitated prior to such retirement. In the case of (d) above the amount of exemption will be to the extent the payment so made does not exceed the contribution made prior to 1-4-1962 and the interest thereon.

SELF-EXAMINATION QUESTIONS—1

1. The various types of incomes that do not form part of the total income of an assessee is specified in Section.

(a) 40 (b) 20 (c) 10 (d) 15. ( )

2. The exemption provided by Section 10(2) in respect of payment by a HUF to its members is subject to the provisions of Section. ( )

(a) 64(2) (b) 10 (15) (c) 17 (d) 54.

3. The exemption in respect of casual and *non-recurring receipt* is available even to receipts arising from business or the exercise of a profession or occupation. This statement is (a) correct (b) wrong. ( )

4. *(i) With effect from the assessment year 1973-74, (i) casual and non-recurring receipts (a) are taxable in full (b) are taxable subject to an exemption of Rs 1,000 (c) are taxable if they exceed Rs. 5,000.* ( )

(ii) Winnings from lotteries, cross-word puzzles, races, etc., would be treated as (a) 'income' (b) casual receipt, *(c) capital receipts (d) speculation profits.* ( )

The exemption in respect of passage money and leave allowance is available to (a) Indian citizens only (b) Indian citizens as well as foreign citizens (c) those who are above 50 (d) married assessees. ( )

6. The Section which governs the technicians whose services in India commence from a date.

(i) before 1-4-1971

(ii) after 1-4-1971 is

(a) 10(6)(vii) (b) 10(6)(ix) (c) 10(6) (viia) (d) 10(9). ( )

7. With effect from 1-4-1971, the definition of the term 'technician'

(i) excludes from its scope experts in

(a) industrial or business management, distribution of electricity or any other form of power (b) mining (c) ship-building ( )

(ii) includes experts in

(a) industrial or business management (b) agriculture. animal husbandry and dairy farming (c) poultry farming. ( )

8. The exemption from tax available to a technician is only in respect of income by way of

(a) remuneration for service in India chargeable under the head 'salaries' (b) interest on securities (c) rents from house property (d) dividends. ( )

9. With effect from 1-4-1971 the amount of exemption available to a technician shall be.

(a) Rs. 4,000 p.m. (b) Rs. 5,000 p.m. (c) the actual remuneration received (d) the actual remuneration received or Rs. 4,0C0 p.m. whichever is less. ( )

10. The exemption will be available for a period of

(a) 36 months (b) 24 months (c) 48 months (d) 60 months commencing from the date of his arrival in India. ( )

11. **The application for approval of the Government is to be made**

(a) within one year from the date of commencement of service (b) before commencement or within six months thereafter (c) two years after the commencement of service (d) before his arrival in India. ( )

12. The exemption in respect of salary income of foreign teachers would be available only

(a) to professors of Mathematics (b) to women (c) if the contract of service has been approved by the Government prior to or within one year from the date of commencement of their services (d) if they stay in India for 5 years. ( )

13. The exemption in respect of allowance payable by the Government outside India would be available only to ( )

(a) Indian citizens (b) Indian citizens who are ordinarily residents in India (c) non-Indian citizens

14 The amount of gratuity received from a State Government is exempt

(a) in full (b) upto 60% (c) upto a limit of Rs. 24,000 ( )

15. In cases where the amount of gratuity received is in excess of the exempted amount, the amount taxable would be

(a) the entire amount (b) the excess over the exempted amount (c) 50% of excess over exempted amount (d) Rs. 3,500

16. With effect from the assessment year 1973-74 the amount of gratuity received by employees of Statutory Corporation will be exempt

(a) in full (b) upto a limit of Rs. 5,000 (c) subject to the same ceiling as is applicable to those in private sector. ( )

17. In the case of payments made by private employers in commutation of pension exemption would be available in respect of

(a) the full amount (b) 50% of the amount received (c) the first Rs. 5,000 (d) the commuted value of one-third of the pension where the employers also get gratuity and the commuted value of one-half of such pension in any other case. ( )

18. In order to be eligible for exemption in respect of payment received from a recognised provident fund the employee should have rendered continuous service with the employer for a period of at least

(a) five years (b) ten years (c) 365 days. ( )

19. In a case where an employee had not rendered continuous service for five years but whose services were terminated due to the discontinuance of employer's business the amount received by him from a recognised provident fund would be

(a) exempt in full (b) chargeable to tax (c) exempt up to a limit of Rs. 6,000

( )

20. The exemption in respect of payment from superannuation funds is specified in Section—

(a) 10(16)(b) 10(10(c) 10(13)(d)15. ( )

2.1 Special house rent allowance [Section 10 (13A)] : Any special allowance specifically granted to an employee by his employer towards payment of rent for residence of the assessee employee is excludible from the total income of the employee subject to the limits prescribed in Rule 2A of the Income-tax Rules, 1962. Rule 2A provides that the least of the following four amounts would be excluded from the total income :

(a) The amount of house rent allowance actually received by the assessee in respect of the relevant period

(b) the amount by which the expenditure actually incurred by the assessee towards payment of rent in respect of the residential accommodation occupied by him exceeds one-tenth of his salary for the relevant period ;

(c) An amount equal to -

(i) 1/5th of the salary due to the assessee in respect of the relevant period if the accommodation is situated at Ahmedabad, Allahabad, Amritsar, Bangalore, Bombay, Calcutta, Cochin Coimbatore, Delhi, Hyderabad, Indore, Jabalpur, Jaipur, Kanpur, Lucknow, Madras, Madurai, Nagpur, Patna, Poona, Sholapur, Srinagar, Surat, Trivandrum, Vadodra (Baroda) or Varanasi (Banaras) ;

(ii) 1/10th of the salary for the relevant period where the residential accommodation is situated at any other place ;

(d) A sum calculated @ Rs. 400 p.m. in respect of the relevant period

Thus, in no case, the exemption in respect of house rent allowance can exceed a sum calculated @ Rs. 400 p.m. For this purpose, the word 'salary' includes, dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites. The expression 'relevant period' means the period during which the accommodation was occupied by the assessee during the previous year

Illustrations

() Mr Raj Kumar has the following receipts from his employer :

(1)	Basic pay	Rs. 3,000 p.m.
(2)	Dearness allowance	Rs. 500 p.m
(3)	Commission	Rs 6,000 per annum
(4)	Motor car for personal use— expenditure met by the employer	Rs. 500 p.m.
(5)	House rent allowance	Rs. 900 p.m

Find out the amount of house rent allowance eligible for exemption to Mr Raj Kumar assuming that he paid a rent of Rs. 1,000 P.M. for his accommodation at Kanpur.

Ans. House rent allowance received by Mr. Raj Kumar shall be exempted from tax to the extent of limits specified under Section 10(13A) read with Rule 2A. Accordingly, the amount of exemption shall be least of the following four limits :

(a) the actual amount received Rs. $900 \times 12 = 10,800$

(b) excess of the actual rent paid by the assessee over 1/10th of his salary = Rs. 12,000—3,600
(Rs. $1,000 \times 12 - 1/10 \times 3000 \times 12$) = 8,400

(c) 1/5th of salary as his accommodation is situated at Kanpur Rs. 7,200

(d) Rs 400 per month Rs. 4,800

Mr. Raj Kumar is eligible for exemption of Rs. 4,800 only under Section 10(13A) read with Rule 2A. The balance of house rent allowance he received i e. Rs. 6,000 shall be included in his total income as a profit in lieu of salary u/s 17(3)

Note : For the purpose of exemption under Section 10(13A), salary as defined in Clause (h) of Rule 2 of Part A of Fourth Schedule includes dearness allowance that too only when terms of employment so provide, but excludes all other allowances and perquisites. Since nothing is mentioned about the inclusion of Dearness Allowance in salary, it has been presumed that it does not form part of salary as per the terms of employment. Hence here salary means basic pay only.

Students are advised to go through the illustrations given in Chapter VII of Sukumar Bhattacharaya's book. Those illustrations would enable the students to understand the operation of the exemptions in respect of gratuity, house rent allowance, salaries of technicians and other exemptions relevant to 'salaries'.

2 19 Special allowance to meet expenses relating to duties to be performed [Section 10(14)]: In order to avail of the exemption under this clause, the following conditions must be satisfied :

Firstly, the payment must have been made by way of special allowance or benefit which is neither an entertainment allowance nor a 'perquisite'. *Secondly*, it must have been specifically granted to meet expenses *wholly*, *necessarily* and *exclusively* incurred in the performance of the duties of an office or employment of profit. Such a special allowance is exempt to the extent such expenses are actually incurred for the purpose. Special travelling allowances and motor-car allowances are covered by this clause.

Where a special separate allowance is specifically granted by the employer to meet such expenses, the case will fall within this exemption. (On the other hand, where no separate allowance is granted but the salary includes a sum to meet such expenses, Section 16(i) would apply and a standard deduction would be allowed from salaries in respect of such expenses incidental to employment) It is to be noted that the exemption under Section 10(14) would be available not only to an employee but also to the holder of an office, the emoluments of which may be taxable as 'income from other sources'.

The Finance Act, 1975 has added an explanation to Section 10(14) which provides that any allowance granted to a person to meet his personal expenses at the place where his duties are ordinarily performed or at the place where he ordinarily resides will not be covered by this provision and no exemption can be claimed in respect of such allowance.

2.20 Interest and other incomes from certain specified sources [Section 10(15)] :

A. The interest and other incomes from certain securities issued by the Central Government or under its authority as also certain deposits in Post Office Savings Bank are excluded from the total income. The types of receipts that are thus excluded from the total income are listed below :

(i) Monthly payments on 15-year Annuity Certificates ;

(ii) Annual payments on National Defence Gold Bonds, 1980

Premium on redemption of Special Bearer Bonds, 1991.

(iii) Interest on —

(a) Treasury Savings Deposit Certificates.

(b) Post Office Cash Certificates ;

(c) National Plan Certificates ;

(d) any other Certificates issued by the Central Government and notified to be exempt under this clause ;

(e) Post Office Savings Bank deposits ; and

(f) fixed deposits under any scheme framed by the Central Government, *e.g.*, 5 year fixed deposits under the Government Savings Certificates Rules, 1968.

Interest on Capital Investment Bonds as notified by the Central Government in the Official Gazette vide notification No F4(1)-W & M/82 dated June 11, 1982. This exemption is provided through an amendment by the Finance Act 1982 with effect from 1st April, 1983. As a result of the amendments made by the Finance Act 1983, exemption is made available to Individuals and HUFs. This amendment is effective from the assessment year 1983-84.

(iv) Bonus in respect of deposits under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959. In all the above cases the amount of exemption is limited to the interest or other income on the amount of certificates or deposits as do not exceed the maximum amount permitted to be invested or deposited therein

As a result of the amendments made by the Finance Act, 1979, with effect from 1-4-1980, (assessment year 1980 81 and onwards) the interest on deposits in a Public Account in the Post Office Savings Bank will be exempt from tax up to Rs. 2,250 For this purpose, a 'Public Account' means an account specified in item (3) in the Table below Rule 3 of the Post Office Savings Banks Rules, 1965.

In addition to the interest or other incomes from the abovementioned securities, interest of the following nature is also excluded from the total income.

B. Interest on securities held by the Issue Department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1919.

C. Interest payable —

(i) by the Government or a local authority on moneys borrowed by it from sources outside India ;

(ii) by an industrial undertaking in India on money borrowed or debt incurred by foreign country for the purchase outside India of raw material or capital

equipment provided that the loan or the debt is approved by the Central Government, to the extent to which such interest does not exceed the amount of the interest calculated at the rate approved by the Government ;

(iii) by Industrial Finance Corporation of India, the Industrial Development Bank of India and the Industrial Credit and Investment Corporation of India on moneys borrowed from sources outside India to the extent to which the interest does not exceed the amount of interest calculated at the rate approved by the Central Government having regard to the terms of the loan and its repayment ; and

(iv) by any other financial institution or a banking company established in India on loans raised in foreign countries under approved agreements for the purpose of advancing loans to industrial undertakings in India for importing raw materials or capital plant and machinery or other goods which the Central Government may consider necessary to import in the public interest.

D. Interest payable by an industrial undertaking in India on moneys borrowed by it in foreign currency from foreign sources under a loan agreement approved by the Central Government having regard to the need for industrial development in India will be exempt from income tax, to the extent to which such interest does not exceed the amount of interest calculated at the rates approved by the Central Government in this behalf, having regard to the terms of the loan and its repayment. For this purpose, the expression 'foreign currency' will have the meaning assigned to it under the Foreign Exchange Regulation Act, 1973

2.21 Educational scholarships [Section 10(16)] : The value of scholarships granted to meet the cost of education would be exempt from tax in the hands of recipient irrespective of the amount or source of scholarship.

2.22 Daily allowance [Section 10(17)] : Any allowance received by the Members of Parliament or of State Legislatures or of any Committee thereof is also excludible from their total income. Under the Members of Parliament (Additional Facilities) Rules, 1975, Members of Parliament are entitled to receive in lieu of certain additional facilities, an allowance at the rate of Rs. 500 per month. With effect from assessment year 1976-77 allowance received under the aforesaid rules also enjoys exemption under the provision It is to be noted that the exemption does not apply to the salary of such members which is subject to tax as 'income from other sources'.

2.23 Awards for literacy, scientific and artistic works [Section 10(17A)] : Awards for literacy, scientific and artistic work as also for proficiency in sports and games, instituted or approved by the Central Government are exempt from income tax.

2.24 Rewards by Government [Section 10(17B) : Rewards given by the Central Government or State Governments for such purposes as may be approved by the Central Government in this behalf in the public interest are also exempt from income tax.

2.25 Gallantry awards [Section 10 (18)] : Payments made by the Central or any State Government in pursuance of gallantry awards instituted or approved by the Central Government shall be excluded from the total income of the recipients. The exemption would be available irrespective of the fact whether the payment is made in cash or kind or whether the recipient is a resident or citizen of India or not.

2.26 Ex-gratia payments on the abolition of privy purse [Section 10(18A)] Any ex-gratia payment made by the Central Government consequent on the abolition of the privy purse would also be exempt from income-tax. Such payments would not be included in the total income of the recipients.

2.27 Annual value of palaces of former Rulers [Section 10(19A)] : The annual value of any one palace in the occupation of former Rulers would be excluded from their total income provided such annual value was exempt from income-tax before the de-recognition of Rulers of Indian States and abolition of their privy-purses.

2.28 Income of local authorities [Section 10(20)] : All income arising to a local authority, other than from a trade or business carried on by it which accrues or arises from the supply of a commodity or service outside its own jurisdictional area is excludible from its total income With effect from 1st April, 1972 exemption is available to income derived by a local authority from the supply of *water or electricity* even outside its judicial area

2.29 Income of Housing Boards [Section 10(20)] : The entire income of the Housing Boards or other statutory authorities set up for the purpose of dealing with or satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages is exempt from income-tax.

2.30 Income of Scientific Research Association [Section 10(21)] : The income of a Scientific Research Association, regardless of its source, which, for the time being is approved by the Central Government or the Central Board of Direct Taxes for purposes of allowing education under Section 35 (1) (ii) shall be exempt from tax. The exemption, however, would apply only to that part of the income which is applied solely for purposes of promoting or carrying out scientific research.

2.31 Income of educational institutions [Section 10(22)] : The entire income of a university or other educational institutions, existing solely for educational purposes and not for purposes of profit is exempt from income-tax.

2.32 Income of hospital, etc. [Section 10(22A)] : Any income of a hospital or other institution run for the reception and treatment of persons during convalescene or persons requiring medical attention or rehabilitation. shall be exempt from tax provided that the hospital or other institution exists solely for philanthropic purposes and not for purposes of profit. It is to be noted that in such cases the entire income is exempt whether or not it is fully spent during the year in which it is earned.

2.33 Income of the Sports Association [Section 10(23)] : The income of an Indian Sports Association or body is exempt from tax if the following conditions are fulfilled :

(a) Its objects are the control, supervision, regulation or encouragement in India of the games of cricket, hockey, football, tennis or other games and sports specified by the Central Government ;

(b) The income is applied or accumulated for application solely to the object for which it is established ;

(c) No part of the income is distributed in any manner to its member except by way of grants to any association or institution affiliated to it ;

(d) The association or body is for the time being approved by the Central Government for the purpose of this exemption by a general or special order.

2.34 **Income of the professional association** [Section 10(23A)] : Associations or institutions of the following classes approved by the Government and applying their income or accumulating it solely to their objects shall be exempt from tax on certain items of its income. The association or institution must :

(a) be established in India.

(b) have as its object the control, supervision, regulation or encouragement of the profession of (i) law, (ii) medicine, (iii) accountancy, (iv) engineering or architecture, or any other profession specified by the Central Government.

All income arising to such an association, *except*, the following categories of income are exempt from inclusion in income :

(a) income under the head 'interest on securities' ;
(b) income under the head 'income from house property' ;
(c) income received for rendering any specific service ; and
(d) income by way of interest or dividends derived from its investments.

2.35 **Income of Institutions established by armed forces** [Section (23AA)]: Any income received by any person on behalf of any Regimental Fund or Non-Public Fund established by the armed forces of the union for the welfare of the past and present member of such forces or their dependents is exempt from tax.

2.36 Income of Institutions established for development of Khadi and Village Industries [Section 10(23B)] : The exemption will be available to institutions constituted as public charitable trusts or registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India existing solely for development of Khadi and Village Industries. Income derived by such institutions from the production, sale or marketing of Khadi or Khadhi products or village industries would be exempt from income tax. The exemption will not be allowed unless the institution applies its income or accumulates it for application, solely for the development of Village Industries. Institutions will qualify for this tax exemption only if they are approved for the purpose of this provision by the Khadi and Village Industries Commision. Khadi and Village Industries Commission will have power to accord approval to such institutions for a period of 3 years at a time.

2.37 **Income of authorities set up under State or Provincial Act for promotion of Khadi and Village Industries** [Section 10(23BB)] : The Finance Act, 1979 has inserted this new clause retrospectively from 1st April, 1962, with a view to granting exemption from income-tax in respect of any income derived by authorities similar to Khadi and Village Industries Commission. set up under any State or Provincial Act, for the development of Khadi or Village Industries in the States.

2.38 **Income of authorities set up to administer religious or charitable trusts** [Section 10(23BBA)] : The Finance Act 1979 has inserted this new clause retrospectively from 1st April, 1962, with a view to granting exemption in respect of income of bodies or authorities established, constituted or appointed under any enactment for the administration of public, religious or charita le trust or endowments (including maths, temples, gurdwaras, wakfs, churches, synagogue, agiaries or other places of public religious worship) or societies for religious or chartitable purpose. It is, however, specifically made clear that the exemption will not apply to the income of any such trust, endowment or society.

2 39 **Income of certain Funds or Institutions** [Section 10(23C)] : An exemption is available in respect of any-income received by any person on behalf of the following entities. :

(i) The Prime Minister's National Relief Fund ;

(ii) The Prime Minister's Fund (Promotion of Folk Art) ;

(iii) The Prime Minister's Aid to Students Fund ;

(iv) Any other fund or institution established for charitable purpose, which may be notified by the Central Government in the Official Gazette, having regard to the objects of fund or institution and its importance throughout India or throughout any State or States ;

(v) Any trust (including any other legal obligation), or institution, being a trust or institution wholly for public religious purposes or wholly for public religious and chartitable purposes, which may be notified by the Central Government in the Official Gazette, having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income accruing thereto is properly applied for the purposes thereof.

In respect of entities listed in (iv) above, the exemption will be available only for the periods specified in the notification.

2.40 **Income of Trade Unions** [Section 10(24)] : A registered trade union within the meaning of the Indian Trade Union Act, formed primarily for the purposes of regulating the relations between workmen and employers or between workmen and workmen, is exempt from tax on its income chargeable under the heads, 'interest on securities', 'income from house property' and 'income from other sources".

2.41 **Income of Provident Funds, Superannuation Funds Gratuity Funds** [Section 10(25)] : Income of recognised provident fund and of an approved superannuation fund or gratuity fund is exempt from tax and the trustees of these funds would not

be liable to tax thereon. The exemption also applies to (i) the interest on securities which are held by or are the property of a statutory provident fund governed by the Provident Funds Act 1925, and (ii) the capital gains, if any, arising to it from the sale exchange or transfer of such securities. With effect from 1.8.1976, exemption under this clause would also cover any income received by the Board of Trustees constituted under Coal Mines Provident Fund and Miscellaneous Provisions Act 1948 and under the Employees Provident Funds and Miscellaneous Provisions Act, 1952, on behalf of the Deposit Linked Insurance Funds established under these respective Acts.

2.42 Income of member of a Scheduled Tribe [Section 10(2)] : A member of a Scheduled Tribe as defined in Articles 365 (25) of the Constitution residing in (i) any area specified in Part A or Part B of the table appended to paragraph 20 of the Sixth Schedule to the Constitution or (ii) in the State of Nagaland, or (ii) in the Union Territories of Manipur and Tripura shall be exempt from tax on his income arising or accruing :

(a) from any source in the area, State or Union Territories afore-mentioned, or

(b) by way of dividend or interest on securities

2.43 Income of residents of Ladakh [Section 10(26A)] : All income arising to a person who is a resident in the district of Ladakh from any source in that district or outside India is exempt from tax from any year upto the assessment year 1979-80. For this purpose, the test of 'residence' is to be determined in accordance with the provisions, explained in Study II.

2.44 Income of Corporation etc., for the Promotion of Interests of Members of Scheduled Castes or tribes or both Section 10 (26B) : Any income of a corporation (established by a Central, State or Provincial Act) or any other body, institution or association (wholly financed by Government) formed for promotion of the interests of the members of Scheduled Castes or Tribes or both is exempt from tax. This provision has been made applicable with retrospective effect from 1st April 1972.

2.45 Tax credit certificates [Section 10(28)] : Amounts adjusted or paid in respect of tax credit certificates granted to the assessee under the Tax Credit Certificates Scheme are exempt from tax irrespective of the residential status of the assessee.

2.46 Income from marketing of commodities [Section 10(29)] : In the case of an authority constituted under any law for the marketing of commodities, any income derived from the letting of godowns or warehouses for storage processing or facilitating the marketing of commodities is exempt from tax.

2.47 Tea Board subsidy [Section 10(40)] : The amount of any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board under any scheme for replantation or replacement of the bushes which may be notified in this behalf by the Central Government in the Official Gazette, will be wholly exempt from tax. The exemption will be available if the assessee furnished to the income-tax office along with his return of income for the

-evant assessment year or within the time extended by the I.T.O. for this purpose, a certificate from the Tea Board as to the subsidy received by him during the accounting

Students should carefully note that all the items listed above (2.1 to 2.43) are altogether exempt from taxation and they are not even includible in the total income of the person concerned.

3. **Tax Holiday for Industrial Units in Free Trade Zones** [Section (10A)]:

The Finance Act, 1981 has introduced in the Income-Tax Act, a new provision Section 10A with a view to provide for total tax exemption in respect of newly established industrial undertakings in the free trade zones. This provision is effective from 1st April, 1981 (Assessment Year 1981-82 and onwards). The objective behind this provision is to encourage establishment of export oriented industries in the free trade zones. At present, there are two free trade zones, viz., Kandla Free Trade Zone and Santa Cruz Electronics Export Processing zone. This concession will also apply in relation to any other free trade zone that may be set up in future and notified by the Central Government for this purpose.

Under this provision, any profits and gains derived by an assessee from an industrial undertaking set up in these zones to which the Section applies, will be exempt for a period of five initial assessment years, commencing from the initial assessement year—the assessment year relevant to the previous *year in which the industrial undertaking begins to manufacture or produce* articles or things—and the four succeeding *assessment years They are referred to as the* 'relevant assessment years'. In order to enjoy this concession, the industrial undertaking should satisfy certain conditions, viz, that it begins to manufacture or produce articles or things during the previous year relevant to the assessment year 1981-82 or any subsequent assessment year in any free trade zone. It should not have been formed by the splitting up or by reconstruction of a business already in existence and it should not have been formed by the transfer to a new business of machinery or plant previously used in any business. For the purposes of this Section, reconditioned imported machinery and plant will be regarded as new. Where the total value of the machinery or plant transferred to the new business does not exceed 20% of the total value of the machinery or plant used in that business, the last mentioned condition will be deemed to have been complied with. Sub-section (4) of Section 10A provides that notwithstanding anything contained in any other provision of the Act in computing the total income of the assessee of the previous year relevant to the assessement year immediately succeeding the last of the relevant assessment years or of the previous year relevant to any subsequent assessment year, the unabsorbed depreciation allowance, the unabsorbed investment allowance, the unabsorbed development rebate, the unabsorbed capital expenditure on scientific research, the unabsorbed capital expenditure for family planning relating to the relevant assessment years will not be taken into consideration. Similarly, unabsorbed business losses or losses under the head 'Capital Gains' or the deficiency relating to tax holiday profits relating to the relevant assessment years will not be taken into account. Where the assessee was entitled to a deduction for the relevant assessment

[illegible] of the profits and gains from newly established industrial undertak[illegible] [illegible] small-scale industries in rural areas or the tax holiday, no de[illegible] [illegible] be admissible in the assessment years subsequent to the relevant assessm[illegible] year. Further, in computing the depreciation allowance on any assets in the a[illegible] ment years following the relevant assessment year, the written down value will be [illegible] puted as if the assessee had claimed and been allowed the depreciation in resp[illegible] the assets in accordance with the provisions of the Income-tax Act during each on the relevant assessment years.

Sub-section (5) of Section 10A provides that where any industrial undertaki[illegible] [illegible]tuated in a free trade zone has begun to manufacture or produce articles or thin[illegible] during any of the previous years relevant to the assessment years 1977-78 to 1980-[illegible] such assessee may at its option before the expiry of the time allowed for the furnishin[illegible] of the return of income for the assessment year 1981-82 furnish to the Income-ta[illegible] Officer, a declaration in writing that the provisions of this Section—namely Section 10A—may be made applicable to him for the relevant assessment years other than the assessment years commencing before the assessment year 1981-82 and if he does so, then the provisions of complete tax holiday specified in this Section will apply for such assessment years and the provisions of new sub-section (4) will also apply to any assessment year following the relevant assessment year.

The provisions of sub-section (8) and (9) of Section 80I relating to tax holiday— transfer of goods for less than market price or arrangement of business in such a way as to produce the assessee more than ordinary profits—have been made applicable to the industrial undertaking referred to in Section 10A also.

Sub-section (7) of Section 10A provides an important option to the assessee not to avail of the benefit of complete tax holiday under this Section and to avail of all other benefits like investment allowance, depreciation, carry forward of business losses, tax holiday benefits under Section 80I, 80HH or 80HHA, as the case may be, just like any other assessee starts a new industrial undertaking. Such an option could be exercised by the assessee before the expiry of the time allowed for filing the return under Section 13) for the initial assessment year, by filing a declaration in writing to the effect that the provisions of this Section may not be made applicable to him for any of the relevant assessment years. In such an event, the assessment will not be entitled to the complete exemption under this provision but would be eligible to claim all other allowances like any assessee. The exercise of the option not to avail of the benefit under this Section would be advantageous in case where the new unit in the free trade zone is iikely to result in a loss during the first five years.

Self-Examination Questions-II

1. The limits regarding the exemption of house rent allowance are prescribed in :

(a) Section 15 (b) Section 16 (c) Section 9 of the Income-tax Act (d) Rule 2A of the Income-tax Rules.

2. The exemption in respect of income from interest or other income in certain cases are specified in Section ( )

(a) 10(2), (b) 10(15), (c) 10(22).

3. The value of educational scholarships is exempt

(a) in full, (b) upto 50%, (c) upto a limit of Rs. 5,000 p.a.

(4) Members of Parliament are exempt from tax in respect of their

(a) business income, (b) salaries, (c) daily allowance, (d) income from dividends. ( )

5. A local authority is taxable in respect of the income derived by it from supply of foodgrains outside its jurisdictional area. This statement is

(a) correct, (b) wrong. ( )

6. The income earned by educational institution is exempt from tax in all cases –This statement is

(a) correct, (b) wrong.

7. An approved professional association is not chargeable to tax on its income under the head 'income from house property'—This statement is

(a) correct, (b) wrong. ( )

8. The income arising from a business carried on by a registered Trade Union is

(a) chargeable to tax in full, (b) exempt from tax, (c) exempt up to Rs. 15000 (d) exempt upto 50%. ( )

9. The exemption available in respect of a member of a Scheduled Tribe residing in specified areas as residents of Ladakh are applicable to

(a) all such persons, (b) all such persons excepting Government servants, (c) all such persons above the age of 40, (d) all such persons whose total income exceeds Rs. 1,000. ( )

4. **Exemption of income of Charitable or Religious Trusts or Institutions :**

4 1 **A general discussion on Trusts** : Before considering the provisions of Sections 11 to 13 which govern the exemption in respect of income from property held for chartitable or religious purposes, let us see briefly what exactly the term 'trust' signifies, the types of trusts and manner of their creation. Though this aspect of the topic does not strictly fall within the purview of our subject, *viz*, income-tax, such a general knowledge would be useful in understanding the provisions of tax laws relating to chartitable trusts.

A 'Trust' is an obligation annexed to the ownership of property and arising out of confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust', the person who accepts the confidence is called the 'trustee' the person for whose benefit the confidence is called, 'beneficiary', the subject matter of the trust is called 'trust property' or 'trust money', the 'beneficial interest' or 'interest' of the beneficiary is his right

against the trustees as owner of the trust property and the instrument, if any, by which the trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups—public and private. The distinction between a public and private trust is that whereas in the former the beneficiaries are the general public or a class thereof in the latter, they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may enure for the benefit of the public. Some religious trusts may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trusts Act, 1882. This Act does not apply to the following :—

(1) The rules of Mohammedan Law as to waqf;

(2) The mutual relations of the members of undivided family as determined by any customary or personal law ;

(3) public or private religious or charitable endowments ; and

(4) trusts to distribute prizes taken in war among the captors.

From the above, it will be clear that public charitable trusts are not governed by the Indian Trusts Act.

Both private and public trusts may be credited *inter vivos* or by will. In the case of public trust, three certainties are required to create such a trust. They are, (1) a declaration of trust which is binding on settlor, (2) setting apart definite property and the settlor depriving himself of the ownership, (3) a statement of subjects for which the property is thereafter to be held. In the case of private trusts also more or less similar requirements exist. A private trust is created when the author of the trust indicates with reasonable certainty by any words or act (a) an intention on his part to create thereby a trust, (b) the purpose of the trust, (c) the beneficiary, and (d) the trust property and unless the trust is declared by will, the author of the trust himself transfers the trust property to the trustee.

A formal deed is not necessary to constitute a public trust or a legal obligation binding on the trustees. In the case of private trusts, if the trust property is immovable property, a registered deed should be executed unless the trust is created by a will. If the trust is in relation to movable property such registration of deed is not required.

The word 'trust' as used in the context of Sections 11 to 13 of the Income-tax Act includes, in addition to the 'Trust' as explained above, *any other legal obligation*. This is made clear in Explanation 1 to Section 13. The words 'any other legal obligation' are wide enough to cover Muslim waqfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a settlement are to pay the income to other trustees who in their turn are bound to apply it for purposes which are religious or charitable.

We have already discussed in detail in Study I, the definition of the expression 'chartitable purpose' [Section 2 (15)]. It includes relief of the poor, education, medical relief and advancement of any object of general public utility not involving the carrying on of any activity for profit. A trust which is created wholly for 'chartitable purpose' within the meaning of this definition would be charitable trust. Similarly, even a legal obligation to apply the income from a particular property for charitable purpose within the meaning of the definition would constitute a charitable trust

Amendment made by the Finance Act, 1983

The Finance Act 1983 has *deleted* the words "*not involving the carrying on of any activity for profit*" appearing in the definition of the term 'charitable purpose' under Sec. 2(15). As a result of this amendment, any objective of general public utility constitute charitable purpose even if it involves the carrying on of any activity for profit. So, a trust will be treated as a charitable trust even if its object involves the carrying on of an activitv for profit. This amendment is applicable for the assessment year 1984-85 and for subsequent assessment years.

Religious purposes : Since Sections 11 to 13 apply to income from property held not only for charitable purposes but also for religious purposes it is necessary to know the meaning of the concept of religious purpose. The expression has not been defined in the Act. However, the meaning of the expression should be taken to include the advancement, support or propagation of a religion and its tenets. For this purpose, no distinction should be made between Hindu and non-Hindu religions. It should be noted that a charitable trust must always be public, but a religious trust may be private or public. The exemption under Sections 11 to 13 is confined to public religious trusts and does not extend to private religious trusts that do not enure for the public benefit This aspect of the problem will be considered in detail at a later stage.

4.2 **Essential conditions for exemption**: The fulfilment of the following conditions is essential to support a claim for exemption of income under Section 11 :

(a) The property, movable or immovable, from which the income derived should be held under trust or other legal obligation.

(b) The property should be so held for charitable or religious purposes which enure for the benefit of the public Where the trust is created on or after 1-4-1962, the whole (and not a part) of the property should be held for charitable or religious purposes. In addition, such trust should also satisfy certain other conditions the non-compliance of which would result in the disallowance of exemption.

(c) The exemption is confined only to the extent to which the income is applied to the charitable or religious purposes or is accumulated for application to such purposes subject to certain requirements, as explained in paragraph 4.4 below.

(d) The application of income for charitable or religious purposes should be within the territorial limits of India except in the two cases specified in paragraph 4.4 (B) below.

(e) Where the trust property consists of a business undertaking, the income shown in the accounts should not be less than the income determined according to the provisions of the Act for computation of 'income from business'.

(f) The person in receipt of the income should make an application (in From No. 10A) for registration of the institution to the Commissioner of Income-Tax before 1st July, 1973 or before the expiry of a period of one year from the date of the creation of the trust or establishment of the institution, whichever is later. The Commissioner of Income-tax is empowered to admit in his discretion, belated applications for registration in deserving cases (Section 12A).

(g) Where the total income of the trust or institution (without giving effect to the provision of Sections 11 and 12) exceeds Rs. 25,000, in any previous year, the accounts of the trust or institution for that year should be audited by a Chartered Accountant or other accountant qualified to be appointed as an Auditor of Companies (Section 12A). The Audit Report and other particulars to be certified by the auditor should be in Form No. 10B.

It is to be noted that exemption under Section 11 would be available not only to trusts, settlements and endowments but also to a Company incorporated under Section 25 of the Companies Act. 1956 without a profit motive or a society formed under the Societies Registration Act, 1860, provided the purposes of the company or society are charitable or public religious purposes within their meaning under the Income-tax Act.

4 3 Extent of exemption and accumulation of Income [Sub sections (1) & (2)] : (A) **Charitable or religious purposes in India** : In order to enjoy the exemption a charitable trust is now required to spend at least 75 per cent of its income every year for the charitable purposes and may accumulate not more than 25% for charitable purposes

Where income is derived from property held under trust which is held partly for charitable purposes and the trust was created before the commencement of the Income tax Act, *i e.* 1-4-1962, it would be exempt to the extent to which the income is applied to charitable purposes in India. Such a trust can also accumulate not more than 25% of its income.

In the case of both these types of trusts, any income which is not so applied is allowed to be accumulated or set apart for future application to charitable or religious purposes, without attracting tax liability, if the trust complies with the following procedural requirements ;

(i) The trust or institution should give notice to the Income-tax Officer specifying the purposes for which the income is to be accumulated and the period for which the accumulation is proposed to be made.

(ii) The income so accumulated should be invested in Government or other approved securities or deposited in the Post Office Savings Banks, scheduled banks including the State Bank of India or its subsidiaries or nationalised banks, or any other Bank included in the Second Schedule to the Reserve Bank of India Act, 1935, co-operative banks or approved financial corporations. The maximum period for which such accumulation is permitted is 10 years and if the accumulated income is not applied for the purposes for which it was accumulated during such period or within one year of the expiry the exemption would be forfeited and tax would be chargeable on the accumulated income.

Where the income is finally set apart for application to such purposes, it would be exempt to the extent to which the income so set apart is not in excess of 25 per cent of the income from such property. In computing the income which is to be applied for charitable objects or which may be accumulated or set apart, voluntary contributions which are not specified to form part of the corpus of the trust would be deemed to be part of the income. Thus, if the trust is not able to apply 75% of its income to its object, the trustees have an option to accumulate such income for a specified purpose or project, for a period upto 10 years by making an application under Section 11(2) provided such income is invested in approved securities. The moneys accumulated or finally set apart should be invested or deposited in the manner referred to in Section 11(2)(b).

Where the income of a charitable or religious trust or institution accumulated or set apart under this provision is not actually applied to the purpose for which it was so accumulated or set apart within the specified period, it will be deemed to be the income of the previous year immediately following the expiry of the specified period.

Where less than 75 per cent of the income derived from property during a previous year is applied to charitable purposes for the reason that the whole or any part thereof has not been received during that year, then so much of the income applied to charitable purposes during the previous year in which the income is received or during the previous year immediately following, may be deemed to be income applied during the previous year in which it becomes due. In other words, where income is not received in the previous year in which it becomes due, the trustees can apply the income in the year in which it is received or in the following year and they can elect to treat the income so applied as income having been applied in the year in which it is derived. Thus in case where the income derived in a previous year amounted to Rs. 1 lakh out of which an amount of Rs. 40,000 was not received during the previous year, the person in receipt of the income could obviously not apply Rs. 75,000 to such purposes In such a case, if an amount not less than Rs 60,000 has actually been applied to such purposes in the year in which the income of Rs. 1 lakh was derived, the deficiency could be made up in the year in which the balance of income is received or in the previous year next following. For availing of the benefit of the extended time beyond the relevant previous year the trust or institution will in either

writing under clause (2) of the Explanation t
case have to exercise an *option in* sub-section (1) or **sub-section 2** of Sectior *Section 11(1) within the time allowed under* *whether fixed originally or an extension. In 139 for furnishing the return of income,* *the extended time shall be deemed to have been come applied to such purpose during the previous year in which it was derived. If the trust applied to such purpose during the subsequent year according to the option exer- does not apply the income during the subsequent year according to the option exer- ised by the trustees, it will be deemed to be the income of such subsequent year to the extent to which the income is not applied to the object of trust.*

Where the full income is received in the year in which it becomes due and for any reason 75 per cant of it is not applied to charitable purpose in the year so much of the income applied for charitable purposes in India during the immediately succeeding previous year in which the income derived may, at the option of the person in receipt of income, be deemed to be income applied during the previous year in which it was derived. In such a case it would not be taken into account in calculating the amount of income applied to charitable purpose during the pervious year immediately following the previous year in which the income was derived. Thus, 75% of the income of the trust in a year may be spent during the previous year, or at the option of trustees, etc , during the next previous year.

Where due to circumstances beyond the control of the person in receipt of income, accumulation cannot be applied for the purposes for which it was accumulated, the I.T.O., may on an application made to him, allow such person to apply such income for any other charitable or religious purposes in India as is specified in the application by such person and as is in conformity with the object of the trust. If the trustees do not apply the income for the changed purpose or project within the period of accumulation, the amount will be treated as the income of the year in which the default takes place.

(B) Charitable or religious purposes outside India.

(i) Where the trust is one created on or after 1-4-1952 for a charitable purpose which tends to promote international welfare in which India is interested, exemption of income from tax would be granted to the extent to which such income is applied to such purposes outside India during the previous year.

(ii) Where the trust or other legal obligation was created before the 1st April, 1952, exemption would be available to the extent to which such income is applied to such purposes outside India

The above two cases constitute exceptions to the rule that no exemption is granted to trusts created for charitable or religious purposes outside India. However, even in the above cases, exemption would be available only if the Central Board of Direct Taxes, by a general or special order so directs. It should be noted that the exemption would be available only in respect of the amount spent for such purposes during the relevant previous year and *not* in respect of income accumulated or set apart for such application in future.

4.4 Treatment of capital gains resulting from the transfer of capital assets held for charitable or religious purposes [Section 11(1A) : Where a capital asset is transferred and the whole or any part of the net consideration for the transfer (i e., full value of the consideration as reduced by the expenditure incurred wholly and exclusively in connection with the transfer) is utilised for acquiring another capital asset to be held as part of the corpus of the trust the capital gain arising from the transfer will be regarded as having been applied to charitable or religious purposes. Where the whole of such net consideration is utilised in acquiring the new capital asset, entire amount of the capital gain will be regarded as having been applied to charitable or religious purposes, while in a case where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gains as is equal to the amount, if any, by which the amount so utilised exceeds the cost of acquisition of the capital asset transferred and the cost of any improvement made to such asset will be regarded as having been applied to such purposes.

In a case where the asset which is transferred, formed part of property held under trust in part only for charitable or religious purposes, a proportionate amount of the capital gain will be regarded as having been applied to charitable or religious purposes Thus, where the whole of the net consideration received as a result of the transfer is utilised in acquiring the new capital asset the whole of the appropriate fraction of the capital gains will be regarded as having been applied to charitable or religious purposes. Where only a part of the net consideration is utilised for acquiring the new capital asset, so much of the 'appropriate fraction' of the capital gains as is equal to the amount, if any, which the 'appropriate fraction' of the cost of the transferred asset will be regarded as having been applied to such purposes The expression 'appropriate fraction', in this context means the fraction obtained by dividing the amount of the income which under the term of the trust is applicable to charitable or religious purposes, by the whole of the income derived from property held under trust in part only for such purpose.

4 5 Forfeiture of exemption [Section 11(3)] : The exemption from tax in respect of income from property held for charitable or religious purposes will be forfeited in the following cases ;

(i) The income is applied to purposes other than charitable or religious purposes or the income ceases to be accumulated or set apart for application to such purposes ; or

(ii) The income ceases to be (a) invested in Government or other approved securities, (b) deposited in any account with any bank (including cooperative land mortgage and development bank) or Post Offices or in an approved financial corporation providing long term finance to industries ; or

(iii) The income is not utilised for the purposes for which it is accumulated or set apart during the period for which it is accumulated or in the year immediately following the expiry of such a period ;

(iv) In the case of a trust or institution, created after 31-3-1962 under the terms of the trust or the rules governing the institution, any part of the trust

income ensures for the direct or indirect benefit of certain specified persons -- This particular situation will be considered in detail in the next paragraph (4 7) In the above cases, on forfeiture of the exemption, the income shall be deemed to be the income of the person in receipt thereof, in respect of the previous year in which the forfeiture takes place.

4.6 **Treatment of Business Income of a Charitable Trust** [Section 11(4A) : The Finance Act 1983 has inserted sub-section (4A) in Section 11 with effect from the assessment year 1984-85 Accordingly the provisions of sub-section (4A) are applicable for the assessment year 1984-85 and for subsequent assessment years. Section 11(4A) specifies the treatment of profits and gains of business carried on by a charitable or a religious trust Accordingly a charitable trust engaged in a business activity will be liable to pay tax on income from such activity *except* in three cases which are discussed later *The trust will not lose its exemption under Section 11 in respect of its income other than business income if the trust maintains separate books of account for its business activity.* A trust will be entitled to claim exemption in respect of its business income in the following cases.

(i) Where the trust is established wholly for public religious purposes and the business carried on by it consist of printing and publication of books or publication of books

(ii) Where the trust is established wholly for public religious purposes and the business carried on by it is of a kind notified by the Central Government in this behalf.

(iii) Where the trust is established wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of such trust.

4.7 **Disallowance of exemption** [Section 13) : In the following cases the trust income shall not be exempt in the hands of the trustees, even if the income is applied to charitable or religious purposes in accordance with the term of the trust :

1. Where any part of the income from the property is held under trust for private religious purposes which does not enure for the benefit of the public, no part of the income would be eligible for the exemption

2. In case of a trust created for a charitable purpose or any charitable institution created on or after 1 4-1962, any income of the trust or institution would not qualify for the exemption under Section 11, if the trust or institution is for the benefit of any particular religious community or caste. However, for this purpose, a trust or institution meant for the benefit of Scheduled Castes, backward classes, Scheduled Tribes or women or children shall not be deemed to be a trust or institution existing for the benefit of a religious community or caste. It is to be noted that this bar applies only to charitable trusts and institutions. The income of religious trusts or institutions would still qualify for exemption even though they may be for the benefit of a particular religious community or caste.

3. In the case of trust or institution created or established after 31-3-1962 if under the terms of the trust or the rules governing the institution, any part of the trust income enures for the direct benefit of certain *specified persons*, no exemption from tax would be available. In the case of a trust or institution, *whenever created or established* the exemption is forfeited also if its income or property is *used or applied*, during the relevant year for the direct or indirect benefit of such person. However, there is one *exception* to this rule. The exemption would operate in the case of trust or institution, created or established before 1-4-1962 where the use of the income or property for the benefit of specified persons is in compliance with any mandatory provision in the terms of the trust or the rules governing the institution.

According to Section 13(3) the persons specified for this purpose are :

(i) the author of the trust or the founder of the institution ;

(ii) any person who has made a substantial contribution to the trust or the institution ;

(iii) where such author or founder is a Hindu undivided family, any member of the family ;

(iv) any trustee of the trust or manager (by whatever name called) of the institution ;

(v) any relative of such author, founder, person, member, trustee or manager ; and

(vi) any concern in which any of the aforesaid person has a substantial interest.

For the purpose of the above provision, the term 'relative' in relation to an 'individual' means.

(i) spouse of the individual ;

(ii) brother or sister of the individual ;

(iii) brother or sister of the spouse of the individual ;

(iv) any lineal ascendent or descendent of the spouse of individual ;

(v) any lineal ascendent or descendent of the individual :

(vi) spouse of a person referred to in (i), (ii), (iii), (iv), or (v) above ; and

(vii) any lineal descendent of a brother or sister of either of the individual or the spouse of the individual.

A person whose total contribution to the trust up to the end of relevant previous year exceeds Rs. 5,000 shall be treated as a person who has made a 'substantial contribution'. The amount of Rs. 5,000 will be reckoned from the date on which the trust or institution is created or established.

It is to be noted that relatives of the author, founder, substantial contributor, trust or manager through their marriage are also included in the above list.

A person will be regarded as having a substantial interest in a concern in the following cases:

(i) Where the concern is a company, if the equity shares of the company carrying not less than 20% of the total voting power are beneficially owned by him or partly by him and partly by one or more of the above mentioned persons : and

(ii) in any other case where such person is entitled either alone or alongwith one or more of the abovementioned persons in the aggregate, to not less than 20% of the profits of the concern.

If the trust or institution engages in any one of the following transactions, the trust income or property would be regarded as having been used or applied for benefit of the persons specified above :—

(a) lending of the income or property of the trust or institution to any one of the specified persons without either adequate security or adequate interest or both;

(b) making available land, building or other property of the trust or institution for the use of any of the specified persons without charging adequate rent or other compensation ;

(c) payment of excessive remuneration to any of the specified persons for services rendered by him to the trust or institution ;

(d) making the services of the trust or institution available to any of the specified persons without adequate remuneration or other compensation :

(e) purchase of shares, securities, or properties for the trust or institution from any of the specified persons for more than adequate consideration :

(f) sale of shares securities or other property of the trust or institution to any of the specified persons for less than adequate consideration ;

(g) division of the income or property of the trust or institution in favour of any of the specified persons where the aggregate of the income or property or diverted in the previous year exceeds Rs. 1,000 ;

(h) investment of the trust funds in any concern in which any of the specified persons has a *substantial interest.*

If the quantum of investment referred to in (h) above does not exceed 5 per cent of the capital of the concern, the trust or institution forfeits exemption from *tax only* in respect of the income arising from such investment.

As per Section 13(1) (bb) in the case of charitable trust or institution which is for the relief of the poor or education or medical relief, the income derived from a business is carried on by such trust or institution would be liable to tax unless the business is carried on in the course of the actual carrying out of a primary purpose of the trust or institution. Therefore, so long as the business is not carried on in the course of the actual carrying out of a primary purpose of the trust or institution, income therefrom would be liable to tax. The Finance Act 1983 has deleted clause (bb) of sub-section (1) of Section 13 with effect from the assessment year 1984-85. Treatment of business income of charitable trusts is embodied in a new sub-section (4A) of Section 11 which has been discussed earlier.

Section 13 (1) (d) and Section 13 (5) seek to regulate the modes and forms in which the funds of trust or institutions claiming exemption under Sections 11 or 12 can be deposited or invested. Section 13(1)(d) provides that if any funds of a charitable or religious trust or institution are invested or deposited or remain invested or deposited in any mode or form other than those specified in Section 1.(5) at any time during any pervious year commencing on or after 1-4 1982, the income of the said trust will lose exemption from income-tax.

Section 13(1)(d) has been made subject to clause (bb) of Section 13(1). The effect of this will be that the restriction in clause (d) of Section (1) will not apply to any investment made in a business by a charitable trust or institution established for the relief of the poor, education or medical relief, if the said business is carried on by the trust or institution *in the course of the actual carrying out of a primary purpose of the trust or institution.*

The forms and modes of investing and depositing funds referred to in clause (d) of Section 13(1) have been spelt out in Section 13(5). For this purpose, the funds of charitable and religious trusts and institutions have been divided into following four types :—

(i) Funds represented by corpus (including original corpus) of any charitable or religious trust or institution existing immediately before 1-6-1973 ;

(ii) Funds represented by corpus coming into existence on or after 1-6-1973 and being either the original corpus or contribution with a specific direction to form part of the corpus, in the form of cash ;

(iii) Funds represented by corpus coming into existence on or after 1-6 1973 and being either original corpus or contribution made with specific direction to form part of the corpus, in the form of cash ;

(iv) Funds other than those represented by the corpus referred to in (i), (ii) and (iii) above.

Funds of the type mentioned at (i) and (ii) above have been grouped into one category and Section 13(5)(b), provides that they may be invested or deposited in any form or mode *except* in *equity* shares of a company which is neither a Government company nor a Statutory Corporation. In other words, in respect of these funds there is no restriction regarding their investment except that they should not be in the form of equity shares of a company which is neither a Government company nor a Statutory Corporation. It may be noted that these provisions do not prohibit investment in the form of preference shares of companies in the private sector.

The funds of the type mentioned at (iii) above fall in another category. Section 13(5)(a) provides the following forms and modes for their deposit or investment ;

(a) Investment in Savings Certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 and any other Securities or certificates issued or to be issued by the Central Government under the savings schemes of that Government ;

(b) investment in immovable property.

(immovable property does not include any machinery or plant even though attached to, or permanently fastened to anything attached to the earth). This additional mode of investment has been provided through amendment made by the Finance Act, 1982 with effect from 1st April, 1983.

(c) deposit in any account with the Post Office Savings Bank ;

(d) deposit in any account with the State Bank of India or with any of its subsidiary banks or with the State Bank or any other bank included in Second Schedule to the Reserve Bank of India Act, 1935 or Cooperative Banks ;

(e) investment in units in the Unit Trust of India ;

(f) investment in any security for money created and issued by the Central Government or a State Government ;

(g) investment in debenture issued by, or on behalf of, any company or corporation both the prinicipal whereof and the interest whereon are fully and unconditionally guaranteed by the Central or State Government ;

(h) investment or deposit in any Government as defined in Section 517 of the Companies Act, 1956

Funds of the type mentioned at (iv) above fall in the third category and Section 13(5)(c) provides that they can be invested or deposited only in any of the forms and modes mentioned at (a) to (d) above.

The provision contained in Section 13(1) which restricts the deposit or investment of the funds of charitable or religious trust or institution to the forms and modes specified in Section 13(5) will not apply, however, to any money accumulated or finally set apart and invested or deposited in the manner referred to in Section 11(2)(b). The exception has been carved out because the form or modes in which the money is accumulated or set apart, referred to in sub-section (2) of Section 11, have been specified in that sub-section itself.

Amendments made by the Finance Act, 1983 regarding Investment of Funds By Charitable Trusts : The provisions of sub-section (5) of Section 13, which have been discussed in the immediately preceding paragraphs, have been deleted by the Finance Act, 1983 with effect from the assessment year 1983-84. Alternatively, a new sub-section (5) has been inserted in Section 11 which specifies the forms and modes of investment to be made by a charitable trust in conformity with Section 11(2)(b). The provisions of sub-section (5) of Section 11 have come into force with effect from the assessment year 1983-84. This sub-section prescribes a new uniform pattern for investment of funds by trust which claims exemption under Section 11. This new pattern of investment will also apply to investment of funds accumulated by a trust for any specific project under Sertion 11(2). The following are the forms and modes of investment of funds specified by Section 11(5).

(i) **National Savings Certificates and other similar certificates issued under Small Savings Schemes of the Central Government.**

(ii) Deposits in any account with Post Office Savings Bank.

(iii) Deposits with a Scheduled Bank or a Co-operative Society carrying on business of banking which include a Co-operative and Mortgage Bank or a Co-operative Land Development Bank.

(iv) Units of Unit Trust of India

(v) Securities of the Central Government or a State Government.

(vi) Debentures of a company or a corporation which are guaranteed bv the Central Government or by a State Government.

(vii) Investment or Deposit with any Government Company.

(viii) Investment or Deposit with any Industrial Financial Corporation approved by the Central Government for the purposes of Section 36(1)(viii)

(ix) Investment or Deposit with any public company engaged in the business of providing long-term finance for construction of residential houses and is approved by the Central Government for the purposes of Section 36(1)(viii).

(x) Investment in immovable property. In this context immovable property does not include plant and machinery even though attached to, or permanently fastened to any thing attached to the earth. However, immovable property include such plant and machinery which is installed in a building for the convenient occupation of the building.

Section 13(1)(d) has been amended by the Finance Act 1983 with effect from the assessment year 1983-84. As per this amendment, the investment pattern for the purpose of claiming eligibility for exemption under Section 11 may be divided into the following three categories.

(i) As regards the assets which form part of the corpus of the trust or institution as on 1-6-1973 the same can be retained if such assets were not purchased by the trust or institution or were not acquired by it by conversion/exchange for any other asset.

(ii) Debentures issued by or on behalf of any company/corporation which were acquired by a trust or institution on or before 28-2-1983 can be retained by it.

(iii) All other funds of a trust or institution have to be invested on or after 1-3-1983 only in the forms and modes of investment specified in Section 11(5) as listed above If any of the funds are invested on or before 28-2-1983 in any other manner, the same will have to be regularised and brought in line with the pattern of investment stated in Section 11(5) on or before 30-11-1983.

Surplus Funds from Business : If separate books of account are maintained in respect of business carried on by a trust, the surplus funds arising from such business are not required to be invested in the forms and modes specified in Section 11(5).

4.9 Income of trust from voluntary contributions [Section (2)] : In Study II, while discussing the definition of 'income', we noticed that the term 'income' includes in its

scope voluntary contributions received by a charitable or religious trust or institution created or established wholly or partly for such purpose not being contribution made with a specific direction that they shall form part of the corpus of that trust or institution.

Section 12 provides that any voluntary contributions received by a trust created *wholly* for charitable or religious purpose or by an institution established wholly for such purposes shall, for purposes of Section 11, be regarded as income derived from property held under trust wholly for charitable or religious purposes. Contributions made with a specific direction that they shall form part of the corpus of the trust or institution will, however, not be treated as income derived from such property.

The provisions of Section 13 will also apply in relation to voluntary contributions in the same manner as they apply in relation to income derived from property held under trust. As a result of such application, the voluntary contributions will qualify for exemption from income-tax only if the conditions specified in Section 11 regarding application of income or accumulation thereon are satisfied. Further, the trust or institution will forfeit exemption from tax if any part of its income or property is applied for the benefit of the trust or founder of the institution, a person who made a substantial contribution to the trust, the relatives of such author, founder, etc.

To put it differently, income by way of voluntary contribution will ordinarily qualify for exemption from income-tax only to the extent it is applied to the purpose of the trust in accordance with the provisions of Section 11. Such charitable or religious trusts will, however, be able to accumulate income from voluntary contributions for future application to charitable or religious purposes for a maximum period of ten years, without forfeiting exemption from tax provided they comply with the prescribed procedural requirements.

It is to be noted that income by way of voluntary contributions received by (i) private religious trusts or institutions established after 31 3-1962, for the benefit of any particular religious community or caste, and (ii) trusts or institutions established partly for charitable or religious purpose *will not be* exempt from income-tax in any case.

Income of Political Parties : Under Section 13A with effect from 1st April 1978, the following categories of income derived by the political party will not be included in computing its total income :

(a) any income which is chargeable under the heads "interest on securities," "income from house property" and "income from other source", and

(b) any income by way of voluntary contributions.

Exemption under the new provision will not be available unless the political party fulfills the following conditions, namely :

(i) the political party keeps and maintains such books of accounts and other documents as would enable the Income-tax Officer to properly deduce its income therefrom :

(ii) the political party keeps and maintains a record of each voluntary contribution in excess of Rs. 10,000 and of the name and address of persons who have made such contribution ; and

(iii) the accounts of the political party are audited by a Chartered Accountant or other qualified accountant as defined in the Explanation below Section 288(2). Term 'political party' for the purposes of the above new provision would mean an association or body of individual citizens of India registered with the Election Commission of India as political party under Paragraph 3 of the Election Symbols (Reservation and Allotment), Order, 1968 and would also include a political party deemed to be registered with the Commissioner under the provision to sub-paragraph (2) of that paragraph. The new exemption will be available only in the case of political parties which satisfy the tests laid down in the aforesaid definition.

Self Examination Questions—III

1. The Indian Trusts Act does not apply to public charitable trusts. This statement is, (a) wrong (b) right. ( )
2. The word 'trust' as used in the Income-tax Act includes, in addition to the concept of trust, (a) any other legal obligation, (b) agreement of sale (c) business. ( )
3. Exemption under Section 11 is available to (a) all religious trusts, (b) Private religious trusts, (c) Public religious trusts, (d) Public religious trusts and Private religious trusts which enure for the public benefit ( )
4. In the case of a trust created on or after 1-4-1962, (a) only a part, (b) the whole, (c) 50% of the property should be held for charitable or religious purpose. ( )
5. In the case of a trust where property is held in trust in part only for charitable or religious purpose exemption would be available only if the trust was created (a) on 1-4-1962, (b) before 1-4-1962, (c) after 1-4-1970, (d) 1-4-1962.
6. In cases covered by Sections 11 to 13 the exemption will be available to the extent of (a) the entire income, (b) 50% of the net income (c) Rs. 20,000, (d) the amount actually applied to the purposes of the trust during the year in which it arises or in the immediately succeeding previous year of it a sum not exceeding 25% of the income from such property is accumulated or set apart for such application. ( )
7. The maximum period for which accumulation of income is permitted is (a) 10 years, (b) 15 years, (c) 7 years, (d) 5 years. ( )
8. In no case, trust created for charitable or religious purposes outside India would qualify for exemption. The statement is (a) correct, (b) wrong. ( )

9. If the income of the trust enures for the benefit of certain persons or is used for the benefit of certain persons the exemption would be withdrawn. These persons are specified in Section [a] 13, [b] 16, [c] 17, [d] 25. ( )

10. If the trust funds are invested in a concern in which the specified persons have substantial interest and if such investment constitutes 3% of the capital of the concern the trust will forfeit the exemption from tax in respect of (a) its entire income, (b) 3% of its income, (c) the income arising from such investment, (d) 5% of its income. ( )

11. If in the above case, such investment constitutes 50% of the capital of the concern the forfeiture of exemption would be in respect of its (a) entire income (b) 50% of its income, (c) the income arising from investment, (d) 75% of its income. ( )

12. Voluntary contributions received by trusts which are applicable solely for the purposes of the trust are exempt from tax in all cases. This statement is (a) correct, [b] wrong. ( )

13. Voluntary contribution received by trust from another trust will *always* be taxable. This statement is [a] correct, [b] wrong. ( )

14. Voluntary contributions received by one trust from another trust will be deemed to be, [a] unearned income, [b] income from house property [c] tax free income [d] income from property held for charitable purposes. ( )

15. Under no circumstances a trust will be allowed to accumulate income from voluntary contributions received by it. This statement is [a] wrong, [b] right. ( )

Answers to Self-Examination Questions—I

1. (c), 2. (a), 3. (b), 4. i, (b), ii, (a), 5. (b), 6. i. (a), ii. (c). 7. i. (a), ii. (b), 8. (a) 9. (d), 10. (b) 11. (b), 12. (c). 13. (a), 14. (a), 15. (b). 16. (c), 17. (d), 18. (a), 19. (a), 20. (c).

Answers to Self-Examination Questions—II

1. (d), 2. (b), 3. (a), 4. (c), 5. (a), 6. (b), 7. (b), 8. (b), 9. (a), 10. (a).

Answers to Self-Examination Questions—III

1. (b), 2. (a), 3. (d), 4. (b), 5. (b), 6. (d), 7. (a), 8. (b), 9. (a), 10. (c), 11. (a), 12. (b), 13. (b), 14. (d), 15. (a).

Krishna March 84, 10,000 (Revised)

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL I. S. P. (N) I Tax—4

INTERMEDIATE COURSE (N)

ELEMENTS OF INCOME TAX LAW

STUDY IV

THIS STUDY COVERS :

I. HEADS OF INCOME (SECTION 14)

II. INCOME FROM SALARIES (SECTIONS 15 TO 17)

III. INTEREST ON SECURITIES (SECTIONS 18 TO 21)

IV. INCOME FROM HOUSE PROPERTY (SECTIONS 22 TO 27)

Prescribed Readings : *Sukumar Bhattacharya's* Indian Income-tax Law and Practice Chapters VII, IX & X

Dr. H.C. Mehrotra's Income-tax Law and Accounts, Chapters VI, VII & VIII.

Heads of Income (Section 14) : The various items of income chargeable to tax under the Income-tax Act must be computed under the six heads of income specified for the purpose, viz. (i) Salaries, (ii) Interest on securities, (iii) Income from house property (iv) Profits and gains of business or profession (v) Capital gains and (vi) Income from other sources.

The expression 'heads of income' should not be confused with the 'sources of income' because for the same head of income there can be various sources and Section 3 of the Act defines the expression 'previous year' with reference to the sources of income and not to the heads of income. Since, for the same head of income there can be more sources than one, it is permissible for the tax payer to have one previous year for one source of business income and another previous year for another sources. The income in respect of both the business should be computed under the head 'Profits and gains of business or profession'.

For the purpose of computing the taxable income and determining the tax liability of an assessee in respect of any particular item of income the various items of income which are chargeable to tax have been divided into six heads mentioned above. But this classification does not mean that there are as many taxes as there are heads of income. The classification of income under various heads does not in any way determine the question whether a particular receipt sought to be taxed as income is capital or revenue in nature. Income-tax is always one tax although the income on which tax is chargeable may arise from different sources to which the different rule of computation laid down for each head have to be applied. The manner of making computation of the taxable income under each head is clearly indicated in the relevant Section of the Act under the concerned head of income It is therefore essential that before income, profit or gains can be brought to charge, they must be assigned to one or more heads of income.

The six heads of income are intended merely to indicate the class of income they do not exhaustively delimit the sources from which income arise. For instance, business income (including capital gains, rent from property, dividends on shares, etc. which are held as business assets), is broken up under different heads only for the purpose of computation of the total income. But by virtue of such a breaking up, the income does not cease to be income from business.

All the six heads of income are mutually exclusive of one another. Since each head is specific to cover the income arising from a particular source or all the sources covered by it, it cannot be said that any one of these heads is more specific than the others Therefore, before an item of income is brought to tax, it must be seen under which head the income falls. This is because of the fact that if an item of income does not fall under any of the six heads it cannot be charged to tax. A particular variety of income chargeable to tax must be assignable to one or the other head of income. If an item of income falls specifically under one head it must be charged to tax only under that head and not under another head. Thus income falling within a specific head cannot be taxed under any other head even if the other head indirectly covers the income. But it may be noted that different businesses do not fall under different heads of income ; all the businesses carried

on by the same person fall under one and the same head'. 'Profits and gains of business or profession'.

Since the charge of income-tax is to be made on the total income of the previous year, the taxable income under each head must first be computed and then the amounts so computed must be aggregated to determine the gross total income A person would thus be taxable on his total income even if his income under each head may be much below the limit for exemption from tax. This distinction between the different items of income chargeable under each head has a direct bearing in regard to the set off of losses computed under the relevant head either in the same year or in their carry forward and set off in the subsequent years.

The significance of the heads of income is that in all cases where a particular item of income has been specifically made chargeable to tax under a distinct head of income it is mandatory for the assessee as well as the taxing authorities to follow the rule ; they have no choice or option in this regard nor can they bring to charge a certain receipt as income under a different head, in lieu of or in addition to the head of income specified for the some. Therefore, even if the assessee, by mistake, includes certain receipts as income under a wrong head, it is the duty of the taxing authorities to determine the head which the income is taxable and bring the income to charge only under the head specifically provided for the purpose ; the Department in such cases, cannot also assess the receipt as income from other sources unless it does not fall under any of the other heads of income.

Just as income from a particular source is made chargeable only under a specific head allotted to it, expenses or losses attributable to income taxable under one head cannot be claimed or allowed under any head. Even under the appropriate head, the allowance in respect of expenses and losses is limited to the extent to which the provisions applicable to that head permit. In case where the expenses or losses are not deductible under the relevant head, either fully or in part they cannot be deducted from income under any other head either in the same year or in the subsequent years.

Although the provisions of the Act are clear and specific as to what items of income should be taxed under which head, problems are likely to arise where the taxability or otherwise of a particular income under a particular head is in doubt. In all such cases the income in question cannot be taxed as if it is income from other sources ; the appropriate head for the income must first be determined before bringing the item to tax. In cases of dispute in this regard the matter may be refer ed to Court for decision since this would be a question of law.

Self-Examination Questions—1

1. The heads of income specified in the Income-tax Act, are (a) 5 (b) 8 (c) 6 (d) 10 (e) 4. ( )
2. Heads of income are specified in Section (a) 15 (b) 18 (c) 22 (d) 28 (e) 45 (f) 14. ( )
3. The function of a head of income is to (a) classify the income (b) distinguish one item of income from another (c) charge income to tax under more heads than one (d) create liability to tax.

4. There are as many taxes as there are heads of income. This statement is (a) wrong (b) correct (c) partly correct and partly incorrect. ( )

5. To charge a particular item of income under the specified head is (a) optional for the assessee and the Department (b) obligatory for the Department and the assessee (c) optional for the Department and obligatory for the assessee. ( )

6. Deduction in respect of expenses and losses allowable in the computation of taxable income (a) should be limited to the limits specified under the respective head (b) would not be subject to any restriction whatsoever (c) if not permissible under one head, can be deducted under another head against income under the head. ( )

Income from Salaries (Sections 15 to 17) :

The meaning of the term 'salaries' for purposes of income-tax is much wider than what is commonly understood. Every payment made by an employer to his employee for services rendered would be chargeable to tax on income from salaries The basis of liability to tax on income from salaries is essentially the relationship of employer and employee between the payer and the receipt of the income. Unless such a relationship exists between the person paying it and the person receiving the income cannot be taxed as salaries. In other words the employer-employee relationship is *sine qua non* for taxing a particular item of income under the head 'salaries'.

The term 'salary', for the purposes of income-tax, has been defined in Section 17 (1) to include—

(1) wages ; (2) annuities ; (3) pension ; (4) gratuity ; (5) fee ; (6) commission; (7) perquisites ; (8) profits in lieu of or in addition to salary or wages ; (9) any advance paid on account of salary ; (10) the amount of employer's contribution to a Recognised Provident Fund in excess of 10% of the employee's salary ; (11) the amount of interest accrued on the accumulated balance of recognised provident fund standing to the credit of an employee to the extent to which the interest exceeds the prescribed rate of interest (viz. 9 per cent with effect from 1st September 1981, 9½ per cent with effect from 2nd June, 1983) (12) the amount of the transferred balance of Recognised Provident Fund to the extent to which it is taxable. However, testimonials and personal gifts which are given purely out of personal affection and regard, although received by an employee from his employer would not be chargeable to tax, as salary income. But allowances (e.g., city compensatory allowance, dearness allowance, etc.), bonus and similar receipts would nevertheless be taxable as income from salaries even though these amounts have not been specifically included in the definition of salary given in Section 17 (1) of the Act. As for house rent allowance received by employees, the entire allowance or a portion of the allowance as determined under Rule 2A of the Income-tax Rules would be totally excluded from the total income. Students may remember that the provisions of Section 10 (13A) have been explained in Study 3.

Liability to tax in respect of salary income : Since the basis of taxability of an item of income under the head 'salaries' is the existence of employer employee relationship, every employee receiving income from his employer for the services rendered shall be liable to tax on the salary due to him. Every receipt which is called 'salary' is not necessarily taxable as income under the head 'salaries' because the name given to the receipt by the parties is not conclusive of taxability of the receipt and head of income under which it is taxable. Thus an agent will be liable to tax under this head in respect of his income from the principal only if (a) the agency amounts to employment, and (b) the agent becomes the servant of the principal by virtue of the agency. However, income arising to a person by virtue of a selling or commission agency or managing agency has specifically been made chargeable to tax as income from business under Section 28 and not as salary income. But the fact that a person holds an office or position and that he receives remuneration by virtue of that office or position does not necessarily mean that the person holding the office is the employee and person paying the remuneration is the employer. For instance, a director of a company, not being an employee or servant of the company would not be taxable in respect of the fees received by him from the company as if it were his salary income, the director's fees would be taxable as income from other sources. But if the director becomes an employee of the company by virtue of the terms of his contract of services with the company remuneration received by him even for specific services rendered would be taxable as salaries.

An official liquidator appointed by the Government under Section 448 of the Companies Act would become an employee of the Central Government and consequently his remuneration would be taxable as income from salaries. Similarly the remuneration paid by a company to its manager, even if he is wrongly designated as director, would be taxable as his salary income regardless of the fact that the amount is payable monthly or is fixed at a certain percentage of the company's profits. But remuneration paid or payable to managing agents by whatever name called and however calculated must be assessed as business income under Section 28 of the Act and not as salaries.

The treasurer of a bank over whom the bank exercises control and supervision would constitute an employee of the bank even if he has *full* control over the staff or his Department and is responsible for all their acts. But the treasurer would not be an employee if the bank does not have any control or supervision. In such cases he would be said to carry on a vocation having due regard to his powers and duties. Therefore, in cases of remuneration paid to a treasurer of the bank it must first be determined whether the treasurer is an employee of the bank and only if he constitutes an employee the income received by him can be taxed as his salary income.

It is essential to distinguish income arising from employment and that arising from a profession or vocation before seeking to tax a certain receipt as salary income. This is necessary because employment is different from profession and income from employment or service cannot be treated as professional income and *vice versa*. Professional income must be taxed under Section 28 and salary income alone can be taxed under this head.

Any other item of income received from any person other than the employer, if not taxable under any of the other specific heads, may be taxed as income from other sources. For this purpose it is immaterial to consider whether they are called salary, wages or remuneration and also whether the payment is made voluntarily or under an agreement with or without adequate consideration.

For purpose of taxing salary income, Section 15 contemplates every kind of servant, however highly or lowly placed he may be, and it refers to every employee of any employer including a local authority, a company, a corporation, any other public body or association, the Central or State Government or any other private employer, whether Indian or foreign. Therefore all persons who hold an office of employment are liable to be taxed on their salary income under this head.

Previous year for salaries : The expression, 'previous year' in relation to salaries would normally denote the financial year, *i.e.*, (1st April to 31st March) immediately preceding the assessment year. The accounting year (s) followed by the employer or former employer or the assessee for his other sources of income would be totally immaterial for the purpose of determining the year of taxability of salary income. The decision of the Andhra Pradesh High Court in *Addl CIT v. K. Ramachandra Rao (1980) 4 Taxman 281 (A.P.)* points out that a salaried assessee can exercise the option available to him under Section 3(1)(*b*) to have the twelve month period for which he has maintained accounts in respect of his new source of employment, as his previous year. Since salaries are generally taxed on due basis, the actual date or year of receipt of salaries would be irrelevant for ascertaining the previous year for the salary income. However, in cases where due to any reason either because the amount of salary has been revised with retrospective effect or where the quantum of salary or bonus is determined subsequently or otherwise the salary or bonus of several past years is received in one year, the total amount is assessable in the year of receipt. The reason for taxing such income in this year of receipt is that such amounts could not have been assessed in the earlier year as the same had not been ascertained or had not become due. In all cases where the income of more than twelve months is included in the total income of one year for the purpose of assessment the employee would become taxable at a rate much higher than that at which he would have otherwise been taxable. In such cases the assessee can claim relief in the rate of taxation under Section 89(1).

Salary received in advance or arrears : According to Section 15 tax is chargeable on all salaries (a) which are due whether actually paid or not, and also those (b) which are paid whether due or not to the employee during the financial year. In view of this specific provision even advance payment of salaries, *i.e.* amount received from the employers for services to be rendered in future would also be taxable in the year of receipt although the salary income is not due to the employee. In other words, salary is taxable at the earliest point of time, *i.e.*, on the date of accrual or on becoming due or on receipt of the salaries. Although salary received in advance is taxable as and when the money is received, loans taken by an employee which are due to be repaid by way of deductions from salary are not

to be treated as salary received in advance and should not, therefore, be subject to tax as salary income of the year of receipt of the loan. It is for this purpose that a clear distinction must be made between an advance of salary and an advance against salary; the former is taxable as income whereas the latter being merely a loan cannot be so taxed.

Mr. A is an employee in X Pvt. Ltd company. In the month of May 1983 he had obtained an advadce of Rs 6,000/- for the purchase of scooter against his salary. Mr A has drawn his salary of April 1984 as an advance on 15th March 1984. For the purpose of computation of Mr A's income for the previous year ended on 31st March 1984 the advance of Rs 6,000/- for the purchase of scooter is not included as it represents a loan taken from the employer which would be repaid by way of deductions from future salary. On the other hand advance receipt of the salary of April 1984 is to be treated as the income of the previous year ended on 31st March 1984 according to Section 15.

However, in order to ensure avoidance of double taxation of the same item of income the Explanation to Section 15 specifically provides that the amount which has already been included as the income of the recipient employee in any year of advance salary in the year of payment shall not again be included in his total income of the subsequent year when it falls due to the assessee. But, if the advance salary has not, for any reason, been taxed as the income of the year of receipt, it must be taxed as the income of the year in which it falls due to the employee.

Additional Emoluments (Compulsory Deposit) Act, 1974 : For the purpose of computing the total income of an employee, the amount credited to his ledger account in the Additional Wages Deposit Account or the Additional Dearness Allowance Deposit Account under the provision of the Additional Emoluments Compulsory Deposit) Act, 1974 shall *not* be included in his total income of the previous year in which it is so credited but so much of the amount as is repaid to him shall be liable to be included in his total income of the previous year in which it is repaid. Section 8(1) of the Additional Emoluments (Compulsory Deposit, Act, 1974 provides that for the purposes of computing under the Income tax Act 1961, the total income of an employee, the amount repaid to him under this Act shall be deemed to be salary paid to him in arrears and the provisions of sub-section (1) of Section 89 of the Income-tax Act shall apply accordingly.

Profits in lieu of salary : As the word 'salary' includes profits in lieu of or in addition to salary or wages the expression has been defined in Section 17(3) of the Act. Accordingly a profit in lieu of or in addition to salary would refer to (i) the amount of any compensation received by an employee from his employer or former employer in connection with the termination of his employment or modification of the terms and conditions relating thereto or (ii) any other payment received by an employee from his present or past employer or from an unrecognised provident fund to the extent to which it does not consist of his own contribution to the fund. Compensation received for termination of employment is a

capital receipt and generally capital receipts are not to be taxed as income unless the law specifically provides otherwise. In this case, since the law specifically provides for taxing the compensation as profit in lieu of salary, it shall be taxable regardless of its capital character. However in all cases where a higher rate of tax is attracted in any year when profit in lieu of salary is charged to tax as income the assessee can claim relief under Section 89(1). A lump-sum paid to an employee by his employer in commutation, reduction or substitution of his salary, pension or other type of income from employment is also taxable as salary income of the years of receipt or the year in which it falls due, whichever is earlier.

Perquisites : Perquisites are an essential part of salary income since 'salary' for all purposes of tax includes perquisites. The term 'perquisite' means any casual emolument, fee or profit attached to an office or position in addition to the salary or wages. Perquisites mostly represent payments to benefit the employees in kind instead of in cash or the provision of facilities or amenities in various forms. The term 'perquisite' has been defined in Section 17(2) of the Act to include the following.

(*i*) The value of any residential accommodation provived to the employee by the employer which is either free of rent or by way of any concession in the matter of rent.

(*ii*) Any payment in discharge of an obligation by the employer, which but for such payment, would have been payable by the employee.

(*iii*) Any sum paid by the employer directly or indirectly for effecting an assurance on the life of the employee or for providing an annuity except in cases where such sum is paid from a recognised provident fund or an approved superannuation fund or Deposit-Linked Insurance Fund established under the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 and the Employees Provident Funds & Miscellaneous Provisions Act, 1952[17(2)(v)].

(*iv*) In the case of an assessee who is (a) a director or (b) and employee being the beneficial owner of at least 20% of the equity shares of a company or (c) an employee getting income from salaries (excluding non-monetary benefit exceeding Rs. 18,000 per annum, the value of any benefit or amenity grante and provided free of cost or at concessional rates would also be taxable as a perquisite.

In addition to the above four categories, perquisites may take a variety of forms; e.g., extra payment for something done outside the duties of office regardless of the fact whether the payment is voluntary or under stipulation, money allowance for clothes or other uniforms, lodging allowance, payment by the employer of lighting, heating and telephone charges of other outstanding in respect of the employees' residence, insurance charges or premia paid by the employee on an endowment policy for ensuring an annuity to the employee on his retirement Lumpsum bonus or bonus calculated with reference to the net profits of the company a lumpsum amount paid to director in consideration of

his withholding or withdrawing his intended resignation, allowance paid to meet the extra cost of living in a foreign country, allowance paid for maintenance and education of children, payment of club fees or bills, cost of legal defence to benefit the employee in criminal or civil litigation, etc.

It may be noted that even if a benefit has been conferred unilaterally without the aid of any agreement, it would constitute a taxable perquisite. However, any unauthorised advantage taken by an employee without the authority of the employer will not amount to a benefit within the meaning of Section 17(2)(iii).

Valuation of perquisites : Perquisites are valued normally on the basis of their value to the employee and not on the basis of the cost to the employer for providing such perquisites. It must be noted that the value of perquisite is included in salary income only if it is actually provided to the employee. For purpose of income-tax, all perquisites, given in cash as well as in kind are to be included in the computation of income from salaries subject however to certain specified exemptions. In cases where the perquisites are in kind it is essential to determine their monetary value before including the same in the salary income. Rule 3 of the Income tax Rules 1962 provides the basis for valuation of some of the important perquisites.

(i) **Value of rent-free residential accommodation** : Salaried tax payers have been classified into *three broad categories* for the purposes of determining the value of the perquisite by way of rent-free residential accommodation provided to them

The *first category* consists of (a) Persons holding an office or post in connection with the affairs of the Union or of a State; and (b) Officers of Government whose services have been lent to a body or undertaking under the control of Government, occupying residential accomodation which has been allotted to the body or undertaking by the Government. In the case of person falling under the aforesaid category, the value of rent-free *unfurnished* residential accommodation provided to him will be taken to be the rent which has been or would have been determined as payable by him in accordance with the rule framed by the Government for allotment of residences to its officers.

If the accommodation is furnished, the value of the prequisites will first be computed as if the accommodation was furnished. The amount so computed will then be increased by an amount equal to 10 per cent of the original cost of the furniture (including television sets, radio sets, refrigerators, other household appliances and airconditioning plant and equipment, if any provided by the employer. If the furniture is hired by the employer, the value of the perquisite increased by the hire charges payable by the employer.

The second category of employees consists of (a) person employed by the Reserve Bank of India, (b) persons employed by a statutory corporation or by a company in which all the shares held (whether singly or taken together) by the Government or the RBI or a corporation owned by that Bank; (c) persons

employed by a body or undertaking financed wholly or mainly by the Government and (d) Officers of Government whose services been lent to or who are employed after retirement from Government services with any company in which not less than 40% of the shares are held (whether singly or taken together by the Government or the Reserve Bank of India or a corporation owned by the Bank.)

In the case of persons referred to in (a) to (d) above the perquisite value of *unfurnished* rent free residential accommodation will be taken to be 10% of the *salary* due to the person in respect of the period during with the residential accommodation was occupied by him in the relevant pervious year. If the accommodation is *furnished* the value of the prequisite will *first* be determined on the above basis and *increased* by an amount equal to 10% of the original cost of the furniture (including refrigerators, television sets, radio sets, other household appliances and airconditioning plant and equipment provided by the employer. In case the furniture is hired by the employer, the hire charges payable for the furniture will, instead, be taken into account.

Employees who do not fall in the first two categories would fall in the *third or residuary category* mainly comprising of employees in the *private sector.* In the case of these persons, the perquisite value of rent-free unfurnished accommodation will ordinarily be taken to be 10% of the salary of the employee in respect of the period during which he occupied the accommodation during the relevant previous year. However if the fair rental value of the accommodation, exceeds 20% of the employees' salary for the relevant period, the income-tax Officer will have the discretion to increase the value of the perquisite (computed on the basis of 10% of salary) by so much of the excess of fair rental value over 20% of the salary, as he may, having regard to the nature of accommodation, deem fit. In the case of employees residing at Bombay, Calcutta, Delhi and Madras, only the excess over 30% of the salary will be added to the basic valuation of 10% of the salary in such cases.

Position with effect from the assessment year 1984-85 in respect of valuation of rent-free accommodation in the hands of employees in Private and Joint Sectors.

Rule 3 (a) (iii) of the Income tax-Rules 1962, has been amended with a view to provide for a relaxation in the matter of valuation of residential accommodation. As per the amendment, only excess of rental value of the accommodation over 60% of the salary will be added to basic value of 10% of the salary in cases, where the accommodation is situated in Bombay, Calcutta, Madras or Delhi. In cases, where the accommodation is situated at any other place, basic value of 10% of salary will be increased by the excess of rental value over 50% of the salary. The amendment is effective from the assessment year 1984-85. It may be noted that this amendment is relevant in the case of employees of private sector and joint sector.

However, in cases where the assessee claims and the Income-tax Officer is satisfied that the sum arrived at on the basis provided above exceeds the fair rental value of the accommodation, the value of the perquisite to the assessee would be limited to such fair rental value.

If the employee is provided with furnished residential accommodation, the value of the perquisite will *first* be computed as if the accommodation were unfurnised and then increased by an amount equal to 10% of the original cost of the furniture (including television sets, radio sets, refrigerators, other household appliances and airconditioning plant and equipment) provided by the employer. If the furniture is hired by the employer, the value of perquisite will instead, be increased by the hire charges payable by the employer.

It may be noted that the perquisite value of free furniture (including television sets, radio sets, refrigerators, other household appliances and airconditioning plant and equipment) provided to all categories of salaried tax-payers will be taken to be 10 per cent of the original cost of such furniture, or where the furniture is hired the hire charges payable by the employer.

It is to be noted that for the purpose of computing the perquisite value of rent-free residential accommodation in the case of employees falling in the second and third categories, the term 'salary' will include pay, allowances, bonus or commission payable monthly or otherwise but will not include (i) dearness allowance or dearness pay, unless it enters into the computation of superannuation or retirement benefits; employer's contribution to the provident fund account of the employee; (iii) allowances which are exempt from payment or tax ; and (iv) any allowance in the nature of an entertainment allowance, to the extent such allowance is deductible under Section 16 (ii). For this purpose, tax paid by employer on behalf of the employee shall be treated as 'salary' as held in *CIT* v *I.G. Mackintosh (1976) 99 ITR 419 (Mad)*; *CIT v. C W. Steel (No. 2) 1972 ITR 821 Ker.)*.

Residential accommodation at concessional rent : If residential accommodation is provided by the employer at a concessional rent, the value of the perquisite will first be determined as if the employee had been provided with rent-free residential accommodation and the amount computed will be reduced by the rent payable by the employee.

1. Mr. Balan who is holding a responsible position in a private sector organisation in Delhi draws a salary of Rs. 24000 p.a. He is provided with a rent-free furnished accommodation by his employer. The fair rental value of the house is Rs. 16,000 p.a. the original cost of furniture provided in the house is Rs. 7,500. Find out the value of perquisite for the assessment year 1984-85.

	Rs.
10% of salary—	2,400
Excess of fair rental value	1,600
over 60% of salary (16,000 − 14,400)	
10% of the original cost of furniture	750
Value of perquisite	4,750

2. What will be the position of Mr. Balan's place of work and residential accommodation are in Nagpur ?

	Rs.
10% of the salary—	2,400
Excess of fair rental value over 50% of salary [16,000—12,000]	4,000
10% of the original cost of furniture	750
	7,150

3. What will be the position, if in the above cases, Mr. Balan happens to be an employee of a public sector undertaking ?

		Rs.
10% of Salary	—	2,400
10% of the original cost of the furniture	—	750
		3,150

4. Will your answer be different if the furniture is not owned by the employer but hired by him at monthly rent of Rs. 100.

In such a case the hire charges of Rs. 1,200 p.a. will be added to the 10% of the salary and the excess of fair rental value over 50% or 60% as the case may be of the salary.

5. What will be the position if the fair rental value of the house provided to Mr. Balan in illustration 1 is Rs. 3840/-only ?

In such a case since the fair rental value does not exeed 60% of the salary (the house being situated in Delhi) or 50% (the house being situated in Nagpur) of the salary, only the basic 10% of the salary and 10% of the original cost of furniture will be taken into account. Consequently the value of the perquisite will be Rs. 3,150.

In all the five cases explained above, if the house is not given to the employee to totally rent-free but at a concessional rate, the value of the perquisite representing the concession would be the difference between the value of the perquisite determined above and the amount in respect of rent received from the employee, For instance, in item 5 above, if the rent received from the employee is Rs. 2,400 p a. the value of perquisite would be Rs. 750 only : if the rent received from the employee is Rs. 3,000 the value of the perquisite would be Rs. 150 only.

In cases where the accommodation is provided by the employer, either free of cost or at concessional rate, the value thereof computed under rule 3 shall be considered as a taxable prequisite under Section 17 (2) (i) or (ii) respectively.

It may be noted that the accommodation provided by the employer either freely or at concessional rate shall be taxed as a perquisite in the case of all salaried persons irrespective of their grade, status etc., in the organisation.

Any benefits or amenities granted or provided free of cost or at concessional rate, shall be treated as a taxable perquisite in the hands of an employee if he :

(i) is a director of company or

(ii) is a person having substantial interest in the company (i.e. a person being beneficial owner of equity shares, etc., carrying not less than 20% of the voting power) or

(iii) is having an income under the head 'Salaries' (exclusive of the value of all benefits or amenities not provided for by way of monetary payment) exceeding Rs. 18,000 per year.

Hence, any person who does not fall in any one of the above three categories shall not be liable to tax in respect of any benefits or amenities provided by the employer either freely or at concessional rate. In the following paragraph certain benefits, amenities which come within the purview of Section 17 (2) (iii) are discussed.

(i) **Value of motor-car or other conveyance :** In all cases where a motor-car or other conveyance has been provided by the employer to his employee the value of the perquisite would depend upon the use of conveyance for the personal purposes of the employee the ownership including hiring rights of the car and the horse power of the car. The value of a motor-car provided by the employer for use by the assessee exclusively for his private or personal purposes must be taken to be the sum actually expanded by the employer in the maintenance and running the motor-car during the relevant accounting year including the normal wear and tear where the motor-car is owned by the employer.

The value of the motor-car provided for the use of the employee partly for his personal purposes and partly for business should be determined to be that part of the sum out of the amount actually expanded by the employer in the maintenance and running of the motor car during the relevant accounting year (including the normal wear and tear where the motor-car is owned by the employer) which can reasonably be attributed to the user by the assessee for his personal or private purposes. But, in cases where the determination of the value of the perquisite on the above basis is difficult, then the value of the perquisite may be determined as under.

(a) Where the motor-car is owned/or hired by the employer and all the expenses of maintenance and running are met or reimbursed to the assessee by the employer, the value of the perquisite would be taken at—

1. Rs 300 per calendar month if the horse power rating of the car does not exceed 16 *or* if the cubic capacity of the engine does not exceed 1.88 litres.
2. **Rs. 400 per calendar month if the horse power rating of the car exceeds 16 or if the cubic capacity of the engine exceeds 1.88 litres.**

(b) Where the motor-car is owned or hired by the employer but the **expenses** of its running and maintenance for his private or personal purpose are met by the assessee from out of his pocket, the perquisite would be valued at—

1. Rs. 100 per calendar month if the horse power rating of the car does not exceed 16 or if the cubic capacity of the engine does not exceed 1.88 litres.

2. Rs 150 per calendar month if the horse power rating af the car exceeds 16 or the cubic capacity of the engine exceeds 1.88 litres.

If the employer also provides a chauffeur for running the motor-car the value of the perquisite computed on the above basis will be increased by sum of Rs. 150 per month.

Even in cases where no particular car is placed at the disposal of the employee but he is allowed the u e of one or more cars of a pool of motor-cars owned or hired by the employee, the value of the perquisite will be computed in accordance with the above-mentioned rates as if the employee had been provided with one motor-car for use partly for his private or personal purposes and partly in the performance of his duties.

In cases where the assessee owns the motor car but the actual running and maintenance charges are met or reimbursed to him by the employer, the value of the perquisite must be determined as the sum actually expended by the employer, which in the opinion of the I.T.O. can reasonably be attributed to the use of the car by the assessee for his private or personal purposes.

The value of the free use by the assessee of any other type of conveyance provided by the employer should be determined at the sum actually expanded by the employer in the maintenance and running of the conveyance during the relevant ac ounting year including its normal wear and tear, if the conveyance is owned by the employer, which, in the opinion of the I T O. can reasonably be attributed to the user by the assessee for his private or personal purposes.

(ii) **Supply of gas, electricity or water :** The value of the benefit to the employee resulting from the supply of gas, electricity or water for his household consumption free of any charge must be determined as the sum equal to amount paid on that account by the employer to the agency supplying the gas, electricity or water. But in cases where such supply is made from the resources owned by the employer without purchasing them from any other outside agency, the value of the perquisite should be taken as *nil*. However, where the I.T.O. is satisfied that the gas, electricity or water supply to any assessee are consumed also for the purposes of his official duties, the I.T.O. must determine the value of the benefit to the assessee to be equal to the amount paid to the employer to the agency supplying the gas, electricity or water on accouut of employee's private use or 6¼% of the salary of the employee whichever is less.

(iii) **Free educational facilities :** The value of the benefit to the assessee resulting from the provision of free education facilities for any member of his household shall be determined as the equal to the amount of the expenditure incurred by the employer in that behalf. But where the educational institution itself is maintained and run by the employer for the benefit of all his employees as a group the value of the perquisite to the assessee shall be determined with reference to the reasonable cost of such education in a similar institution in or near the locality. In cases where the educational institution run by the employer is open for outsiders besides for employees children, there would be no taxable perquisite.

(iv) **Free transport facilities :** The value of the perquisite representing any benefit or amenity resulting from provision by any undertaking engaged in the carriage of passengers or goods to any employee of the undertaking or to the members of his families or his dependent relatives, of journey free of cost or at concessional fares, in any conveyance owned by the undertaking for the purpose of transport of goods or passengers must be taken as *nil* In view of this provision, free travelling passes provided to railway employees or airlines are treated as tax-free perquisites.

(v) **Domestic servants provided by employer :** The taxable perquisite in the hands of an employee on account of services of servants provided by the employer shall be calculated in the following manner as per the executive instructions circular No. 133 dated 10-12-1969).

(a) Sweeper	75% of actual wages or Rs. 60 p.m. whichever is less.
(b) Gardner (c) Watchman	50% of actual wages or Rs. 60 p.m. whichever is less.

But, in accordance with the Board's revised circular No. 123 dated 19th October, 1973, in cases where the accommodation is owned by the employer and is occupied by the employee, there will be no taxable perquisite in the hands of employee in respect of the provision of gardener by the employer However, the value of gardener's services as computed above (i e. 50% of actual wages or Rs. 60 p m. whichever is less) shall be added to the fair rental value of rent free accommodation provided by the employer.

(vi) **Other perquisites :** The value of any benefit or amenity not included in preceding categories is to be determined on such basis and in such amount as the I.T.O, considers fair and reasonable. In such cases the I.T O. may value the perquisite on a basis which is considered reasonable by him.

Perquisites under Section 17 (2) (iv) : Any payment in discharge of an obligation by the employer, which but for such payment, would have been payable shall be a taxable perquisite in the hands of all categories of employees. Certain varieties of payments which may be considered as perquisites within the purview of Sec. 17 (2) (iv) are like tax dues of employees met by the employer, club bills &

subscriptions only where benefits/facilities proved not limited entirely to official duties.

Regarding the perquisite taxable under Section 17 (2) (v), students may refer to the discussion on Page 8.

Medical facilities : The provision of *ordinary medical facilities* made by an employer to an employer or his family free of charge or *reimbursement of such medical expenses* to the employee after they are incurred by him, is not to be included in the total income of the employee provided that such amount does not exceed in any financial year one month's salary of the employees (salary for this purpose includes only dearness allowance if the terms of employment so provide but exclude any other allowance/perquisite) or Rs 5,000 whichever is less. In cases the value of benefit is above the specified limits, it shall constitute a taxable perquisite in the hands of all categories of employees. [Circular No. 336 dated 16 4 82].

Modifying its earlier Circular No. 336, dated 16-4-82, the CBDT issued a circular vide No. 376 dated 6-1-84. In its later circular, it is provided that the value of provision of ordinary medical facilities by an employer to an employee or his family free of charge or reimbursement of such medical expenses to the employee after they are incurred by him is not to be included in the total income of the employee if such value in a financial year does not exceed Rs. 5,000 per annum. If such value exceeds Rs. 5,000, only the excess amount will be liable to tax. This classification is effective from assessment year 1984 85 onwards.

Perquisites not chargeable to tax : The following items of perquisites are wholly exempt from tax in the hands of all employees :—

(i) provision of free refreshment during office hours (but not lunch) ;

(ii) provision of recreation facilities for groups of employees provided the facilities are not restricted to a few ;

(iii) provision of free or concessional transport facilities to the employees as a group and not to any individual employee alone from their places of residence to the office and back.

It must be noted that insurance premium paid by the employer under certain Schemes such as Group Insurance Scheme, Employees' State Insurance schemes and Fidelity Guarantee Scheme, is not regarded as perquisite in view of the fact that an employee has merely an expectancy of benefit in such schemes.

Exemptions : In addition to the above exemptions the following items of salaries, allowances and perquisites are wholly exempt from tax in the employee's hands viz.

1. Leave travel concessions received in cash or kind by Indian citizens from their employers for proceeding on leave or on retirement or termination of services to their home districts or to any other place within India [Section 10 (5)].

2. In the case of assessees who are not citizens of India.

   (a) Travel concession for proceeding to home country on leave after retirement or termination of service.

(b) Salaries paid to employees of foreign Governments.
(c) Salaries paid to employees of foreign enterprises
(d) Salaries of foreign technicians.
(e) Salaries of employees of foreign ships.
(f) Salaries of foreign professors and teachers.
(g) Payments to research scholars.

3. Allowances and perquisites paid to Indian citizens being employees of the Government of India for services outside India [Section 10 (7)]

4. Remuneration of employees under the co-operative technical assistance programme [Section 10 (8)].

5. Death-cum-retirement gratuities [Section 10 (10)]

6. Amounts received in commutation of pension [Section (10A)].

7. Encashment of earned leave at the time of retirement on superannuation or otherwise u/s 10 (10AA).

8. Payments received from a statutory provident fund [Section 10 (11)].

9. Accrued balance of a recognised provident fund [Section 10 (12)].

10. Payments received from an approved superannuation fund [Section 10 (3)].

11. House rent allowance received from the employer [Section 10 (13A)].

12. Any specific allowance (not being an entertainment allowance for performance of duties) e g., travelling allowance [Section 10 (14A)].

The details of the above exceptions and the conditions or limits subject to which they are granted (to the assessee) have already been discussed in Study Paper III.

However, gifts received by an employer from his employee on account of the personal regard or affection which the employer has for him, not being in the nature of income, cannot be treated as a perquisite for tax purposes and consequently the question of taxing or exempting it would not arise.

Deductions allowable in computing income under the head 'Salaries' (Section 16). The taxable income from 'salaries' must be computed after allowing the following deductions.

Standard Deduction [Section 16 (i)]; Section 16 (i) dealing with standard deduction has been subject to frequent amendments made by successive Finance Acts. The current position with reference to the assessment year 1984-85 and to subsequent assessment years is given below.

Standard deduction at all levels of salary income will now be allowed at the uniform rate of 25% of such salary subject to a maximum of Rs 6,000 (Rs. 5,000 for the assessment year 1983-84).

For the purpose, the term 'salary' will include fees, commission, perquisites or profits in lieu of or in addition to salary, but will not include payments received by the employee which are specifically exempt from tax under subsection (10) (10 A) (10 AA) (10B), (11) (12) and (13A) of Section 10. It may be recalled that these clauses, confer exemptions respectively on gratuity, payment in commutation of pension, compensation for loss of employment, payment from statutory and recognised provident funds and house rent allowance.

The standard deduction will, however, be limited to Rs. 1,000 in the following two cases :

(a) where he is provided with any motor-car, motor cycle or scooter or other moped by his employer (for use otherwise than wholly and exclusively in the performance of his duties) ; or

(b) where he is allowed the use of any one or more motor cars (otherwise than wholly and exclusively in the performance of his duties) out of a pool of motors car owned or hired by the employer.

It may be noted that the standard deduction on the above basis is to be allowed irrespective of the fact whether any expenditure incidental to employment is actually incurred by the employee or not. According to the cirular No 131 dated 18th March, 1974, issued by the Central Board of Direct Taxes, the use of a motor car by the employee for the purposes of going from his residence to the place where the duties of employment are to be performed or from such place back to his residence, will not be regarded as use of the motor car in the performance of his duties. Consequently in such cases, the standard deduction will be restricted to Rs. 1,000 only.

It may be noted that standard deduction would also be admissible to pensioners.

(ii) **Entertainment allowance [Section (16) (ii)]** : In case of Government employees ; any allowance in the nature of an entertainment allowance specifically granted to the employee by the Government is deductible from the gross salary. *The maximum amount of deduction should not, however, exceed (a) the amount* of allowance actually received and included in the salary income (b) a sum of Rs. 5000 or (c) one-fifth of the employee's salary *whichever is the least.* This deduction in the case of Government servant is allowable, regardless of the date from which he is in the service of the Government and also regardless of the date from which he is getting entertainment allowance from the Government; Thus if an employee whose annual salary income is Rs. 30,000 is getting Rs. 9,000 as entertainment allowance from the Government the sum of Rs. 9,000 will first be included in his total salary income and deduction will then be allowed to the extent of Rs. 5,000.

(b) In the case of any other employee, the deduction in respect of entertainment allowance would be allowed *only* if he has been getting entertainment allowance from the *same employer from a date prior to* 1-4-1955. In other words on deduction in this respect would be allowed to an employee (i) who has not been getting the allowance before 1-4-1955 even if he had beed serving the same

employer before 1.4 1955 or (ii) to an employee who has changed from one employer to another after 1.4.1955 even though he might be getting the allowance from both of them. Further, the deduction in respect of entertainment allowance is available only if the allowance has been received regularly and continuously from the same employer from a date prior 1.4.1955. Thus an employee who was employee before 1.4.1955 and was receiving entertainment allowance would not be entitled to get the deduction even if he has not been getting the allowance for some time either because he changed his job for a short period or because he went abroad or because he was not given the allowance by the same employer for any other reason. If all the aforesaid conditions are fulfilled and the assessee is entitled to the deduction, the amount deductible would be the *lowest* of the following four amounts : viz

(a) the amounts of allowance actually received and included in the salary income.

(b) the amount received from the same employer prior to 1.4 1955 ;

(c) a sum equal to one-fifth of the salary; or

(d) Rs, 7,500.

The term 'salary' for this purpose should be taken to exclude any allowance, benefit or other perquisite.

Therefore, if an employee who is receiving Rs. 60,000 as salary and Rs. 12,000 as entertainment allowance was getting only a sum of Rs. 2,400 p a. as entertainment allowance from the same employer before 1.4.1955, he would be entitled to a deduction of Rs 2,400 only. But if, in this case, the same employee had been getting an allowance of Rs 9000 before 1.4.1955, the deduction would be limited to Rs. 7,500.

Mr. X gets an entertainment allowance of Rs, 10,000 per annum from his employer. He draws salary of Rs 2,500/- per month and he does not get any other allowance or bonus. Let us consider the deduction available to him under Section 16 (ii) under the following circumstances.

(a) He is a Gevernment employee.

(b) He has been working in A Pvt. since 31-3-1974. But he was drawing Rs 4,500 per annum as entertainment allowance upto 31-3-1955.

(c) He worked in M Pvt. Ltd. upto 1-5-1959 and drew entertainment allowance of Rs. 6,500/- per annum. But he joined the present employer on 30-6-1959.

Ans. (a) He is eligible for a deduction of Rs. 5,000 as it is the lowest of the three, viz.

(1) One fifth of salary $\left(\frac{2,500 \times 12}{5} = 6,000 \right)$

(2) Rs. 5000 (3) Rs. 10,000 (the actual amount received).

(b) In this case he is eligible for Rs. 4,500/- as the **lowest of the amounts** mentioned below :

(1) One-fifth of salary (Rs. 6,000)
(2) Rs. 7500.
(3) *Entertainment allowance drawn prior to 1.4 1955* (Rs. 4500)
(4) *the amount of allowance actually received.* (Rs. 10,000)

(c) *Since Mr. X has changed his employment after 1-4-1955, he is not eligible for any deduction under Section 16 (ii).*

It must, however, be noted that the amount received as entertainment allowance must first be included in the total salary income in every case regardless of the question of its deductibility. The deduction is allowable in computing the taxable income only if the various conditions are fulfilled, the amount of deduction being limited to the least of the four amounts specified above The allowability or otherwise of the deduction does not, however, depend upon nor is limited to the amount actually expended by the employee towards entertainment out of the allowance so received.

Surrender of salaries : Since salary is normally taxble as soon as it becomes due to the employee the subsequent non-receipt of salary which has been taxed when it was due would not in any way affect the tax liability of the employee. Likewise. salary which is either foregone or voluntarily surrendered by the employee would also be generally disregarded in determining the tax liability of the assessee, The reason for ignoring the non-receipt or surrender of salary is that the surrender being only an application it would be immaterial for tax purposes However, if any salary due to an emyoloyee is voluntarily surrendered by him to the Central Government at any time after 31-3-1961 under the provisions of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961 the amount so surrendered should not be included in the employee's total income chargeable to tax. The tax exemption is available to Government servants as well as any other empolyee who, in the public interest may wish to surrender the salary to the Central Government.

Disallowance of salaries and perquisites paid to the employee in the assessment of the employer : This topic is discussed in Study Paper 5 in detail Students should note the disallowance of salaries, etc, as items of business expenditure in the assessement of the employer does not in any way affect the taxability of the amount in the empolyee's hands. Therefore, the taxability or otherwise of a particular item of salary or perquisite in the hands of the employee should be considered independent of and without looking into the question of deductibility or otherwise of the same in the assessment of the employer.

Deduction of tax at source : According to Section 192 of the Act, every person responsible for paying any income taxable under the head 'salaries' is statutorily obliged to deduct tax on the amount chargeable at the rates applicable to the estimated total income of employee under the head 'salaries for the financial year in which the salary is due to that employee. In all cases where tax is

deductible at souree by the empolyer, the employee should not be called upon to pay the tax himself to the extent to which the deduction has been made.

The tax deducted at source and paid to the Government is deemed to have been paid by the employer for and behalf of the employee concerned and, consequent credit must be given to empoloyee in his assessment in respect of the tax deducted and paid on his behalf by the employer. *But the taxable income of employee must be computed by including the amount of tax deducted as part of his salary income.*

Payment of tax free remuneration by an employer to his employees is not permissible under the law. In case of companies : Section 200 of the Companies Act, 1956 has specially prohibited payment of tax-free remuneration to the employees. *There are however, only two exceptions to this rule*, viz., payment of *tax free remuneration* to foreign technicians and foreign teachers is permissible in certain circumstances Section 10(6) (as discussed in Study Paper III). In all other cases, the gross salary before making deductions on account of Income-tax, provident fund, insurance premia, etc., should be taken to be gross salary of the employee for the purposes of Section 15. It is from that figure of salary, that the various deductions permissible under Section 16 should be made in order to arrive at the taxable income from salaries.

Provident Fund.—For purposes of income-tax provident funds can be divided into four kinds, viz.

(a) *Statutory Provident Funds* : Provident Funds which are set up under the Provident Funds Act, 1925 are called statutory provident funds. Provident funds of institutions, like universities, colleges and similar education institutions, Reserve Bank of India, State Bank of India, Government of India and State Government would fall within the category of Statutory provident funds.

(b) *Recognised Provident Funds* : Provident funds which are recognised at the time of their setting up or subsequently and which continue to be recognised by the Commissioner of Income tax under Rule 3 Part A of the Fourth Schedule to the Income-tax Act, 1961 and Provident Funds established under a scheme framed under the Employees Provident Funds Act, 1952 are known as recognised provident funds Provident funds of many public sector undertakings, semi-government organisations and other institutions or organisations which are recognised by the Commissioner, for income-tax purposes would come under this category.

(c) *Unrecognised Provident Funds* :—A provident fund which is neither statutory nor recognised, as stated above, would be treated as an unrecognised provident fund for income-tax purposes.

(d) *public Provident Funds* : The provident fund set up by the Central Government in exercise of the powers conferred on it by Section 3 of the Public Provident Fund Act, 1968, with effect from 1.7.1963, is called the Public Povident Fund.

Treatment of contributions to and payments from Provident Funds

(i) In the case of a statutory provident fund the entire amount of the employer's contribution, without any limits, and interest thereon shall not be includible in the total income of the employee both during the time of contribution and at the time of payment or otherwise. The full amount of the employee's own contribution without any limit shall rank as qualifying amount for deduction from gross total income under Section 80C. The amount of contribution however is includible in the employee's salary for ascertaining the gross total income.

(ii) In the case of a recognised provident fund the employer's contribution in excess of 10% *of the salary is to be treated as latter's income from salaries for* the year in which the contributions were made. But the employer's contribution upto 10% of the salary of employee is not to be included for tax purposes. Only the excess amount of interest over a sum calculated @ 9% p.a., (with effect from 1st September 1981) of the balance standing to his credit is includible in the total income. The employee's contribution will be included in total income for ascertaining the gross total income of the assessee but will qualify for deduction under Section 80C. The amount qualifying for deduction would be ; (i) the sum actually contributed : or (ii) 1/5th of the employee's salary: or (iii) Rs. 10,000 whichever is the least. Thus even if the employer's contribution is in excess of 10% of the salary and employee's contribution is in equal amount, the entire amount of the employee's contribution will qualify for deduction subject, however, to the over-all limits. *The term 'salary' for this purpose includes dearness allowance if the terms of employment so provide, but excludes all other allowances and perquisites.*

Payments of accumulated balance in Recognised Provident Fund ;

The accumulated balance payable to an employee participating in RPF shall be exempt provided that he satisfies *anyone* of the following conditions.

(i) He has rendered continuous service with his employer for a period of 5 years or more.

(ii) His services have been terminated by reason of his ill-health or by the contraction or discontinuance of the employer's business or by any cause beyond the control of the employee.

(iii) On the cessation of his present employment, the employee obtains employment with any other employer, to the extent the accumulated sum payable to him is transferred to his individual account in any recognised provident fund maintained by such other employer.

In computing the period of continuous service for the purposes of clauses (i) and (ii), the period (s) for which such employee rendered continuous service under his former employer (s) shall be included provided that accumulated balance payable from RPF maintained by his present employer includes any amount transferred from his individual account in any other recognised provident fund (s) maintained by former employer (s).

(iii) In the case of an unrecognised provident fund the assessee's contribution ... be included in his total income in full and no part thereof and the interest ...reon would rank for any deduction. The entire amount of the employee's and ... employer's contribution shall be ignored during the period of service. But ...e entire amount of the employer's contribution and interest thereon shall be taxable as the salary income of the year in which amount is paid to an employee. In appropriate cases, the assessee can claim the relief under Section 89 (1). The interest on the employee's own contribution to the unrecognised provident fund must be taxed as income from other sources but not as salary income as and when interest becomes due.

In any case where an unrecognised provident fund maintained by an employer is accorded recognition, the balance of each employee in such fund shall be considered to the extent of balance in the new fund, as 'transferred balance'. The tax liability of employee in respect of such 'transferred balance' is explained below :

1. It shall be presumed that as if the transferred balance has been accorded recognition since the date of institution of fund.

2. The aggregate of all sums comprised in a transferred balance which would have been liable to tax since the beginning shall be deemed to be income received by the employee in the previous year in which the recognition is accorded.

3. The Commissioner is empowered to make a summary calculation of aggregate taxable portion of transferred balance in cases of serious accounting difficulty.

4. No relief by way of refund or otherwise shall be granted in respect of any sum comprised in transferred balance.

(iv) In the case of Public Provident Fund, the individual subscribers are entitled to the same tax concession as available to the participants of the statutory or recognised provident funds. As a result, the subscriptions to the fund qualify for tax relief by way of deductions from the gross total income; alongwith savings through other specified media such as life insurance policies 10 year and 15 year accounts under the Post Office Saving Bank (Cumulative Time Deposit Rules). The tax concession, however, is subject to the overall qualifying limits prescribed by the Act. [Section 80C (2) (a) (vi)] Any amount received from the fund is also exempt from income tax in the hands of the recipient in the same manner as in case amount received from the other provident funds. Thus, the amount received from this fund do not form part of the total income of the assessee [Section 10 (11)]

2.10 **Approved Superannuation and Gratuity Funds** :—A superannuation fund which has been and continues to be approved by the Commissioner of Income-tax under Rule 2 of Part B of the Fourth Schedule to the Act is known as an approved superannuation fund for income-tax purposes. A superannuation fund which is not recognised or which does not continue to be so recognised would

be an unapproved superannuation fund. Contribution made by the employer to a superannuation fund, whether approved or not, does not affect the assessment of the employee except at the time of payment. But contributions made by the employee to an approved superannuation fund shall rank for deduction along with provident fund contributions, insurance premia, etc. No limit has been prescribed in this regard as in the case of a recognised provident fund. Payment by way of pension of annuity after superannuation are taxable as salary income irrespective of the fact whether they are paid out of an approved superannuation fund or an unapproved superannuation fund. Section 10 (13) provides exemption in respect of certain payments from an approved superannuation fund. But payments from an unapproved superannuation fund are chargeable to tax as profits in lieu of salary in the year in which such payments fall due to or are received by the employee to the extent to which such payments do not consist of contributions by the employee or interest on such contribution.

An approved gratuity fund is one which is approved by the Commissioner of Income-tax under Rule 2 of Part C of the Fourth Schedule to the Act. The employee is not normally required to be made any contribution to the fund. So the question of granting relief or deduction and the limits in respect thereof does not arise. But payments received by the employee from a gratuity fund whether approved or unapproved which are in excess of the amount exempt under Section 10(10) would be includible in the total income of the employee and taxable as the income of the year in which the amount is due to or received by him.

2.11 Deduction of tax from salaries : Under the provisions of Section 192 of the Act any person responsible for paying any income chargeable under the head 'salaries' to any person is bound, at the time of payment to deduct income-tax of the amount chargeable at the rates applicable to the estimated total income of the assessee under this head in the financial year in which the salary is paid. Accordingly a provision has also been made under Section 205 of the Act that where tax is deductible at source under Section 192, the assessee shall not be called upon to pay the tax himself to the extent to which it has been deducted from that income.

Mr. Sudhakar, an employee of a private company situated in Delhi furnishes the following details of his salary income for the financial year ended 31st March, 1984.

Basic pay Rs. 3,000 p.m. Bonus Rs. 5,000; Commission Rs. 7,000: Advance salary for the month of April 1983 Rs. 3,000; Conveyance allowance Rs. 450 p m. (Rs. 300 spent wholly for official purposes); Employer's contribution to Recognised Provident Fund (RPF) Rs. 6 000; Interest credited in RPF @ 9 per cent Rs. 10,000; Provision of a car of 10 H.P. with a chaffeur—used for official and personal purposes ; Reimbursement of medical bills Rs. 7,000.

He is provided with a rent-free furnished accommodation. Its annual rental value is Rs. 34,000. Cost of furniture in the house Rs. 30 000. Provision of domestic servants, sweeper and watchman (salary of Rs. 175 p.m. paid by employer to each of them). The accommodation is owned by the employer.

Compute Mr. Sudhakar's income chargeable under the head 'Salaries' for the assessment year 1984-85.

Computation of Taxable Salary Income of Mr: Sudhakar for the Assessment year 1984-85.

(Previous year ended 31st March 1984)

		Rs.
Basic pay Rs. 3,000 × 12		36,000
Bonus		5,000
Commission		7,000
Advance salary u/s 15(b)		3,000
Conveyance allowance		1,800
(Rs. 300 p.m. spent wholly for official purposes is exempt under Section 10(14) balance of Rs. 150 is taxable).		
Employer's contribution to RPF in excess of 10% of salary (see Note 1)		2,400
Provision of car (See Note 3)		5,400
Provision of domestic services (sweeper, watchman (See Note 4)		1,440
Reimbursement of medical bills (See Note 5)		2,000
Valuation of rent-free furnished accommodation		
	Rs.	
10% of salary	4,980	
Annual rental value in excess of 60% of salary (Rs. 34,000-29,880)	4,120	
Value of unfurnished accommodation	9,100	
Add ; 10% of cost furniture	3,000	
Value of furnished accommodation (See Note 6)	12,100	12,100
		76,140
Less : Standard deduction under Section 16 (i)		6,000
Taxable Salary income		70,140

Notes

1 Employer's contribution to recognised fund in excess of 10% of salary shall be liable to tax as income deemed to be received during the year under Section 7.

2. As the interest is credited at a rate of 9%, which is less than the prescribed rate, there will be no tax liability on this account.

3. With the given information in the question, the proportionate amount of expenditure incurred on maintenance of car for personal purposes cannot be computed. Hence the value of perquisite is taken as Rs. 300 p m. in respect of provision of car and Rs. 150 p m in respect of provision of chaffeur.

4. In case of sweeper, 75% of actual wages or Rs. 60 p m. whichever is less and in case of watchman 50% of actual wages or Rs. 60 p m. whichever is less, shall constitute perquisites taxable u/s 17(2)(iii). [Circular No. 133 dated 10-12-1969].

5. Reimbursement of medical bills amounting in excess of Rs. 5,000 shall be liable to tax.

6. For the purpose of valuation of rent-free furnished accommodation, salary in the instant case includes, bonus commission, non-exempt portion of conveyance allowance i e. Rs. 36,000 + 5,000 + 7,000 + 18,000 = 49 800. It may be noted that advance salary for the month of April, 1983 is not includible.

Self-Examination Questions-II

7. The basis of charging a particular receipt as income from salaries is (a) Partnership between the recipient and the payer (b) employer-employee relationship (c) a contract of sale (d) contractual undertaking between the two persons to treat the receipt as salary income.

8. Income from salaries is normally taxable on (a) actual basis (b) due or receipt basis whichever is earlier (c) at the discretion of the assessee (d) due basis (e) at the discretion of the I T.O. [ ]

9. For purposes of taxation of salaries the previous year shall normally be (a) the calendar year (b) the financial year (c) the accounting year of the employer (d) accounting year of the employee (e) the year in which salary income is declared in the return filed by the assessee.

10. Salary received in advance (a) is not taxable since it is a liability representing money received in advance for services to be rendered in future (b) is a loan and consequently the question of its taxability does not arise (c) is taxable as the income of the assessee. [ ]

11. Salary received in advance is—

(a) taxable later on when it becomes due (b) not taxable either at the time of its falling due since it is not received (c) taxable as the income of the year of receipt (d) is kept in suspense until it becomes due. [ ]

12. An item of salary received in advance is taxable –
(a) only once at the time of receipt (b) twice once when it is received and again when it becomes due (c) first as soon as it is received but the assessment will be cancelled later on when the amount becomes due by including it in the income of the later year (d) is not again taxed when it becomes due. [ ]

13. The terms (i) 'salary' (ii) 'perquisite' and (iii) 'profits' in lieu of or in addition to salary' are defined in Section.
(a) 17 (3) (b) 17 (1) (c) 16 (d) 17 (2) (e) 15.

14. The cost of defending a suit incurred by an employer on the behalf of an employee even without the latter's consent is (a) taxable as income from other sources (b) exempt from tax (c) treated as a perquisite and taxable as salaries (d) taxable subject to a limit of an amount that would have been spent by the employee had he defended himself.

15. For the assessment year 1984-85 the standard deduction is subject to a ceiling of (a) Rs. 6,000 (b) 5,000 (c) Rs. 2,500.

16. The maximum amount of deduction, allowable in respect of entertainment expenditure in the case of Government employees is limited to lower of (a) Rs. 6,000 (b) Rs. 7,500 (c) Rs. 5,000 (d) Rs. 1,000 (e) Rs. 12,000 or (ii) (a) 1/6th (b) 1/8th (c) 1/10th (d) 1/12th (e) 1/5th of salary.

17. Non-Government employees will be entitled to a deduction in respect of entertainment allowance only if they have received the same continuously from their present employers from a date prior to (a) 1.1.1954 (b) 1.4.1955 (c) 1.4.1961 (d) 1.4.1962 (e) 28.2.1970.

18. The amount of deduction on account of entertainment allowance permissible in the case of non-Government employees is not to exceed (i) (a) Rs. 5,000 (b) Rs. 7 500 (c) Rs. 11,000 (d) Rs. 12,000 (e) 6,000 (ii) (a) 1/6th (b) 1/4th (c) 1/8th (d) 1/5th (e) 1/10th of salary or (iii) the amount received prior to (a) 1-4-1955 (b) 1-4-1954 (c) 1-4-1961 (d) 1-4-1971 whichever is the least. [ ]

19. The amount of standard deduction in respect of expenditure incidental to employment is allowable at the rate of 25% of the salary upto a maximum of Rs. 6,000 to assessees in case where the employee is not in receipt of (a) an entertainment allowance (b) dearness allowance (c) conveyance allowance from the employer (d) any conveyance provided by the employer. ( )

[illegible] the case of person in receipt of [illegible] the assessment year 1984-[illegible] [illegible] (b) Rs. [illegible] (c) Rs. [illegible] (d) Rs. 5,000 (as in [illegible])

21. With effect from the assessment year 1975-76, the separate deductions in respect of purchase of books from tax on profession and expenses on travelling and other conveyance (a) are not available (b) are replaced by standard deduction.

22. The salary of an employee for the month of March, 1984 is to be taxed as his income of the (a) calendar year 1984 (b) financial year 1983-84 (c) accounting year of the Government ending on 30-6-1983 (d) financial year 1984-85.

23. Personal gifts, presents and testimonials received by an employee from his employer in appreciation of his meritorious work are (a) taxable as salaries (b) taxable as income from other sources (c) not taxable at all (d) taxable as capital gains.

24. Salary paid to an employee which is disallowed as a deduction in computing the taxable income of the employer is (a) totally exempt from tax in the employees hands (b) includible in the employee's total income only for rate purposes (c) taxable in full in the employee's hands (d) entitled to relief under Section 89 (e) split into two parts and taxed equally in the hands of the employer and employee.

3. INTEREST ON SECURITIES (Sections 18 to 21)

General :—Under this head tax is primarily chargeable on the amount of 'interest on securities' specified in Section 18(1) but not that received on securities issued by a foreign Government or a foreign company or that received on deposit of money in a fixed deposit account of any other account. Interest received in the last mentioned cases is charged either under the head 'Income from business' (Section 28) or 'Income from other sources' (Section 50). 'Interest on Securities' must be brought to charge under this head even when the securities are held as a business asset or are dealt with as a stock-in-trade, as in the case of bank. The term 'Securities' as used in this Section means securities by (i) the Central Government, (ii) State Government, (iii) a local authority, (iv) a company, or (v) a statutory corporation. Thus debentures or other securities for money issued by a company would fall within this Section. It is to be noted that the term 'securities' for thispurpose does not cover shares.

'Interest on Securities' shall be assessed as the income of the previous year in which it had accrued and fallen due to payment for that in which it has received if it was not assessed at the time it has become due. Such a provision in certain c ases might cause some hardship, inasmuch as that by the inclusion of the amount

interest both on accrual and on receipt basis, an assessee may be called upon to pay tax on a higher slab of income in the same year. To mitigate such a hardship a provision has been made under Section 89 (2) for relief to be granted by the Income-tax Officer on an application being made by the assessee in accordance with Rule 21 B of the Income-tax Rules.

Interest on securities must be wholly regarded as the income of the *person who is the legal owner of the securities at the time when the interest falls due for payment irrespective of the fact whether or not the person was owner throughout the period for which the interest is paid.* This provision would apply even in case where the interest falls due after the death of owner. In other words, a part of the interest apportioned to the period upto the death should not be treated as the income of the deceased.

In cases where the securities giving rise to the interest income represent an asset transferred by the assessee to any person without adequate consideration and the provisions of Section 64 apply, the interest income will be first computed under this head and then included in the total income of the transferor as his income from other sources for purposes of assessment.

If an assessee has a brought forward losses computed under the head 'profits and gains of business or profession' these losses could be set off against the current year's income by way of interest on securities which are held as stock in trade of assessee subject, however, to the conditions that (i) the time limit of 8 years had not elapsed ; and (ii) the business in which the loss was incurred is continued to be carried on by the same assessee. This principle has been laid down by the Supreme Court in *C I T. vs. Cocanada Radhaswami Bank (1965) 57 I.T R. 306. For the* purpose of computing the income under this head interest should not be deemed to have accrued from day to day, but on certain fixed dates on which it falls due for a payment. When securities have been purchased at a price expressed as a capital sum *plus* interest computed from day to day from the last date of payment of interest to the date of sale, the purchaser is assessable on the whole amount of interest received by him on the next due date and he is not entitled to any deduction in respect of the interest paid by him to the vendor. For the same reason, the seller of securities-cum-interest is not assessable on the amount he receives in respect of interest from the purchaser. This rule must, however, be read, subject to the provision of Section 94 which hits as those who seek to avoid tax by systematic sale of securities-cum-interest. Under that Section the Income-tax Office may, in certain circumstances, deem the interest on securities to accrue from day to day and tax the seller on that basis.

5.2. Deductions

(a) In the case of assessees other than banks (Section 19).

(*i*) *Collection charges* : The assessee is entitled to an allowance by way of deduction in respect of any sum reasonably expended by him for the purpose of realising the interest on securities (*e g.* bank charges for collections). But an

assessee who collects the interest himself and on his own behalf cannot charge a fee for his efforts and claim it as a deduction under the clause.

(ii) *Interest on borrowing*: The amount of interest payable by the assessee (whether actually paid by him or not) on moneys borrowed for the purpose of investment in the securities is allowable as a deduction. In order to claim this deduction the money must have been borrowed by the assessee solely and specifically for the purposes of investment in the securities and not for any other purpose. The deduction is permissible without any condition or exception provided that the interest on borrowed moneys is payable in India, whether taxable or not. The deduction is available even if (i) the interest on borrowed moneys is payable at a rate higher than the rate of interest on securities; (ii) the securities have yielded less or no income during the relevant previous year.

Where the total amount of deduction exceeds the income from securities the resultant loss can be set off against the assessee's income under any other head in same year; but such a loss cannot be carried forward. Whether interest on any security is exempt from tax by virtue of its being tax-free issue by the Central or State Government, the assessee cannot claim any deduction in respect of the interest on moneys borrowed for investment in the tax-free securities so as to adjust such a deduction against the interest on taxable securities provided that the borrowings and the investments could be identified or apportioned between the tax-free and taxable securities.

(b) In the case of banking company (Section 20).

(i) *Collection charges*: The amount deductible in this regard shall be calculated as under:

$$\frac{\text{Expenses of the bank X interest on securities (gross)}}{\text{Gross receipts of the bank from all sources}}$$

The expenses to be taken into account for the purpose are those covered by Sections 30, 31, 36 and 37 other than the ones enumerated in section 36(1)(iii) (vi) and (vii). In other words, expenses by way of rents, rates, tax, repairs and insurance for the buildings, plant, machinery and furniture, premium, on the insurance of stocks or stores, bonus or commission to employees, contribution to a statutory or recognised provident fund or an approved superannuation fund or an approved gratuity fund, special reserve by a financial corporation (subject to the limits), expenses on family planning and other revenue expenses wholly and exclusively incurred for the purpose of the business shall rank for deduction in this regard. Thus in the case of a banking company a part of the overhead and the running expenses which would normally be allowable as business expenditure is allowable as deduction by way of collection charges.

(ii) *Interest on money borrowed* In the case of banks, money borrowed would also include money received by way of deposit of all types. The deduction in respect of interest on borrowing will have to be calculated by applying the following formula:

$$\frac{\text{Interest payable on borrowing and deposits} \times \text{Interest on securities (gross)}}{\text{Gross receipts of the bank from all sources}}$$

In calculating the proportionate amount of deduction, only the interest on securities which are taxable but not those which are exempt shall be taken into account. The entire amount of interest paid by the bank on its borrowing and deposit received in the normal course of its business should, therefore be allowed as a deduction between the two heads of its income, viz, interest on securities and income from business irrespective of the fact whether the bank has purchased taxable or tax-free or exempted securities,in the normal course of its business

It has been specially provided that a part of the amount claimed as deduction by a bank from its income from securities shall not again form part of the deductions allowable to the bank in computing its business income.

3.3 **Amounts not deductible** (**Section 21**) : This Section provides that if interest is payable outside India and chargeable under the Income-tax Act in the hands of the lenders *e.g.*, under Section 9(1)(i), it is not a permissible deduction in the assessment of the prayer from his income chargeable to tax under any head except in case where (i) the interest is on a loan issued for a public subscription before 1st April, 1983 : or (ii) tax has been paid or deducted at source in respect of such interest ; or (iii) there is a person in India who may be charged as an agent under Section 163 in respect of such interest.

These restrictions on the deduction of interest payable to a lender outside India, and chargeable under this Act have been evidently inserted to counteract evasion of tax payable by the lender in respect of the interest that he received.

3.4 **Deduction of tax at source** : Under Section 193 of the Act, any person responsible for paying interest on securities, chargeable to tax under this head must at the time of payment, deduct income-tax at the rates prescribed by the Finance Act in force on the amount of interest payable.

3.5 **Tax concessions** : *Total Exemptions* : In the following cases income arising from securities issued by or on behalf of the Central Government are not to be included in the total income and hence are totally exempt from tax ;

(a) The Government may declare by notification in the Official Gazette certain specific securities as tax-free for non-resident. Any income from interest on such securities arising only to non-residents shall be totally exempt from tax [Section 10(4)].

(b) Interest received from the following investments issued by or on behalf of the Government are totally exempted from tax : (i) Monthly payments on the 15-year annuity certificate : (ii) Interest on Treasury Deposit Certificates ; (iii) Interest or income arising from all Postal Savings Certificates [Sections 10(16) (ii)].

(c) Income under the head 'interest on Securities' arising to (i) a sports association ; (ii) an authority constituted for providing housing accommodation ;

(iii) a hospital or other institutions ; (iv) a registered trade union ; (v) the trustees of a recognised provident fund ; (iv) a provident fund set up under the Provident Funds Act, 1925 ; (vii) the trustees of an approved superannuation fund ; (viii) the trustees of an approved gratuity fund ; (ix) the members of Scheduled Tribes as mentioned in the provisions of Section 10(26) ; (x) a local authority ; (xi) a scientific research association ; (xii) a University or other educational institutions.

Interest received on securities issued tax-free by the Central or a State Government is to be included in the total income of the assessee for rate purposes and a rebate is allowed thereon. The rate of rebate shall not exceed 27-1/2% (Section 86A).

Lower rate of tax (Section 112A): Income from interest on National Savings Certificates (First Issue) including Bank Series, enjoy a tax concession. The tax on such interest is payable at the rate applicable to the total income excluding this interest. Thus, if an assessee earns Rs. 16,000 out of which Rs. 1,000 is the income from N S.C. (Ist issue) tax will be calculated on Rs. 15,000 and an average rate arrived at. The rate will be applied to Rs. 16,000 and tax charged thereon.

Self-Examination Questions—III

26. Interest on securities is taxable on (a) due basis (b) accrual basis (c) receipt basis (d) the basis of entries in the accounts of the assessee.

27. Interest on the securities is taxable as the income of (a) the financial year (b) accounting year followed by the assessee (c) assessment year (d) calendar year.

28. The term 'securities' in relation to those issued by companies will mean (a) shares (b) loans (c) investment (d) debentures (e) securities received for advancing loan (f) mortgages.

29. Interest on securities which was not charged to tax in the year in which it was due but received in a later year is taxable (a) as the income of the financial year in which it is received (b) as the income of the accounting year in respect of which it is received by reopening the earlier assessments (c) as the income of the accounting year in which it is received (d) concealed income resulting in the levy of penalty and conviction. ( )

30. If an assessee earns interest @ 5% from the securities held by him but the interest payable by him on the money genuinely borrowed for purposes of investment is @ 10% the assessee would be entitled to deduction of the interest on borrowings at a rate not exceeding (a) 10% (b) 9% (c) 5% (d) 12% (e) 6%.

31. Interest received on tax free securities (a) is not at all entered in the books of account (b) is not at all taken into account for tax purposes whether the income is included in the account or not, (c) is wholly exempt from tax under Section 10(d) is first included in the total income and then given a rebate at the average rate of tax.

32. The rebate in respect of interest on tax-free securities shall be either at the average of tax or at the rate of (a) 25% (b) 27 [illegible] (c) 33-1/3% (d) 50% (e) 51% (f) 75% whichever is less.

IV. Income from House Property (Sections 22 to 27).

General : Income-tax is payable under the head 'Income from house property' on the basis of the annual value of the property consisting of any buildings or land appurtenant thereto. In order to be charged to tax, the assessee in whose hands the income is sought to be taxed must be the legal or beneficial owner of the property. No tax can be levied on the assessee in respect of the income from the property if he is only a tenant or occupant of the house but not the legal owner thereof. The scope of Sections 22 to 27, which deal with income from house property is very much limited and precise. Section 22 has application to "property consisting of any buildings or lands appurtenant thereto". It charges to tax in the hands of the owner the annual value of house property. Section 22 specifically excludes from the scope portions of the house property [i] which the owner may occupy for the purposes of any business or profession carried on by him [ii] the profits of which are chargeable to income-tax. If both these conditions are fulfilled, the house property [illegible] Section 22. The reason for such exclusion seems to be [illegible] property constitutes one of the commercial assets and [illegible] commercial assets put together which produce business income [illegible] income computed in accordance with the [illegible] chargeable to income-tax, it would be unfair to [illegible] asset separately and fix a notional income thereof [illegible]. In respect of buildings, etc., owned by the assessee and used for [illegible] his business or profession, depreciation, etc. is allowed under Section [illegible]. No depreciation is allowable in respect of buildings [illegible] ass-essable under Section 22.

In cases where assessees carrying on business of [illegible] selling, etc. have constructed residental quarters and let them [illegible] employees, as incidental to their main business the letting out of residential quarters [illegible] subservient and incidental to the main business and the income arising therefrom could be chargeable as business income and Section 22 would not apply [illegible], if any, charged for such property *Jamshedpur Engineering and Machine Manufacturing Co. Limited (1951) 32 I.T.R 51 (Pat.) and C I.T. v Delhi Cloth and [illegible] Mills Co. Ltd (1976) 56 I.T.R. 162 (Del.)*]

In Smt Kala Rani v. CIT (1981) 6 Taxman 226, the Punjab and Haryana High Court held that ownership by virtue of sale deed in one's favour is not a precondition to assess him under Sec. 22 and that in any given case it is found that the fact that the assessee is in occupation of the building as owner for all intents and purposes except the sale deed in his favour, then he is liable to income under Sec 22.

The Bombay High Court held in *CIT v Smt T.P. Sidhwa (1981) 21 CTR (BOM)* 146 that the assessee whose rental income from the house property of

[illegible] was not chargeable to tax under the [illegible] could not be brought to tax. [illegible]

[illegible] in cases where the property is situated abroad the income from such [illegible] although the acquisition of the property would be assessable under Section 22 [illegible] might have been made in the course of the business of the assessee. But [illegible] derived from vacant plots of land on which no building is constructed [illegible] chargeable to tax under this head but as income from other sources in all cases. However, when the landed property is held as current asset of a property dealer or is acquired in the ordinary course of business, income from such land would not be assessed as business income even if the house property is held as a fixed or current asset of a business. The income from such property would be assessable under the head 'income from house property' but not as business income.

Basis of charge :—The subject of charge under the head is the annual value of property. In other words, tax is levied not upon the actual income from the property but upon the notional income represented by the annual value. The tax is charged on the artificial figure of income even if in fact the owner receives no income whatsoever, or even if there is no possibility of his receiving any income from the property. For instance, the trustees of a trust would be taxable on the annual value of the trust property even though under the will or trust deed the property could not be let out to any one but had to be given free of rent to certain beneficiaries, for charitable or religious purposes. The liability to tax is not also dependent in any way on the ability or right of the owner to let out the property or his capacity to realise the *bona fide* annual value of the property. The tax liability under this head springs directly from the fact that the assessee is the legal beneficiary or deemed owner of the property.

The tax chargeable in respect of the annual value of the property is based upon the ownership and not the mere occupation or possession thereof. Ownership for this purpose, means the ownership of the annual value. Ownership again will depend upon the related circumstances of each case. For instance, in cases where the property is held in trust, the assessment under Section 22 may be made either on the trustees or on the beneficiaries. Similarly, if the owner of the property becomes insolvent, the official assignee or receiver under the law of insolvency would be chargeable to tax in respect of the income from such property as if he were the actual owner (and not the insolvent). But where the receiver is appointed by the court, the property does not vest in him and consequently, he would not be liable to tax in respect thereof as owner. However, an assessment could be made on him in representative capacity in accordance with the provisions of Sections 160 and 161. If the property is mortgaged, it is mortgagor (and not the mortgagee) who would be liable to tax as the owner and for this purpose the nature or purpose of the mortgage is immaterial in cases where the property is owned by a partnership firm and not the partners who would be chargeable to tax under this Section irrespective of the fact whether the firm is registered, unregistered or treated as registered,

The owner of a building is taxable in respect of the income therefrom even though he is not the legal owner but only a long term lessee of the land on which the building is erected because the person who builds a superstructure on a plot of land belonging to another would constitute the owner of the superstructure during the currency of the lease. On the expiry of the period of lease the owner of the superstructure would cease to be the owner of the building if the terms of the lease deed provide that the building should belong to the lessor. But in the case of a short-term lease of a building the lessee is not assessable as the owner of the building under Section 22 and consequently *income derived by him from subletting or reletting the building or from assessment of the lease must be assessed as income from other sources. For this purpose the fact that the owner is under certain legal or other restrictions and obligations in regard to transfer of disposition of the property would not in any way affect his liability to tax.*

The question of ownership in all cases must be determined with reference to *the accounting year and the assessment year.* Therefore, the owner of a property would be assessable under this head even if he was not the owner of the property in the earlier year or had ceased to be owner in the subsequent year.

In cases where there is a dispute in regard to the title to the property the income-tax authorities are bound to decide whether the assessee sought to be taxed as *prima facie* the owner of the property or not ; they are neither concerned with nor entitled to decide the question of dispute as to title. Even if a suit has been filed in the Court as a result of the disputed ownership of the property, the tax authorities cannot wait for the decision of the court to make assessment. If, however the court's subsequent decision is contrary to the stand taken by the tax authorities the latter are bound to rectify the assessment and to pass all such consequential orders as may be necessary.

Where a house property is owned jointly by two or more persons and their respective shares are definite and ascertainable the owners must be charged to tax individually in respect of their shares in the income from the property ; they cannot be assessed as an association of persons [Section 26]. In cases where the property is owned by a Tenants' Co-operative Housing Society or Tenant's Co-partnership Housing Society every member is deemed under Section 27(iii) to be the owner of the portion of the property allotted or leased to him and consequently assessable individually in respect of the income from the portion of the property under his occupation. Where the property is tranferred by any person to his/her spouse or minor child not being a married daughter otherwise than for adequate consideration except when the transfer in the case of the wife or husband is in connection with agreement to live apart, the transferor is deemed under Section 27 to be the owner of the house property and is liable to be taxed in respect of the income from the property under Section 64(1)(iii) & (iv). Likewise the holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate [Section 27(ii)].

Annual value [Section 23] :—The annual value of the property which is the basis of charge is the sum for which the property might reasonably be expected to

[illegible] words, *annual value is the fair rent derived* [illegible] *having regard to all the prevailing* [illegible] *demand for houses in that locality and the* [illegible] *other relevant factors.*

[illegible] signifies the sum for which the property might [illegible] from year to year. In case where a property is [illegible] receivable by the owner in respect thereof [illegible] the property, the amount so received or [illegible] annual value of the property. In other words, [illegible] of a tenant and the rent paid or payable [illegible] determined to be the sum for which the [illegible] be let out from year to year the annual [illegible] the actual rent. For example, the fair rent [illegible] Rs. 7,200 p.a. If this property is actually let [illegible] the annual value would be taken to be Rs. [illegible] p.a.

[illegible] actual rent' would mean the actual rent received [illegible] of the previous year where the property is [illegible] In any other case, it would denote the amount [illegible] amount of the actual rent received or [illegible] period for which the property is let, as the period [illegible]

[illegible] property is let out, the rent receivable by the [illegible] actual rent received. The rent received by [illegible] the sum equal to the amount he had actually [illegible] expenses if any in respect of the property which [illegible] rent or otherwise. If the property is [illegible] easing or reducing rate of rent the [illegible] averaging. Where the property consists of a [illegible] rental value of each unit must be ascertained [illegible] would be assessable as the actual value of [illegible] value of the same property may vary from year to year. [illegible] payable in respect of the income from the [illegible] The valuation adopted by the municipality or [illegible] *prima facie*, be taken as the annual letting value of the [illegible] where [illegible] received by the landlord does not represent the [illegible] The amount of municipal taxes expenses in respect of repairs, [illegible] adjusted against the rent by the landlord or tenant [illegible] the annual value although the whole of such expenses may be allowable as a deduction in computing, the taxable income from the property.

Deduction of Municipal Taxes: The full amount of taxes levied by any [illegible] local authority in respect of the property is allowable as a deduction from the gross annual value of the house property. The deduction would, however, be limited to the extent to which such taxes are *borne by the*

owner of the property. The deduction allowable in this regard is in respect of both municipal taxes as well as service charges levied and [not merely collected] by the local authority. The allowance by way of deduction in respect of municipal tax is permissible in every case regardless of the fact whether [i] the house is in the occupation of a tenant or the owner himself: [ii] the amount of municipal tax has actually been paid before the end of the accounting year or not The date of completion of construction is also immaterial for the purpose of allowing the deduction on account of municipal taxes.

Allowance for newly built residential houses: With a view to encouraging the construction of house properties which reduce the problem of shortage of house the Income Tax Law provides for a concessional tax treatment of income from newly built houses which are *let out.*

(i) *Houses construction of which was begun after 1st April 1961 and completed before 1st April 1970* : In these cases the special deduction allowable shall be a sum of Rs. 600 per each residential unit or the amount of the annual value (after deduction of municipal taxes) whichever is less

(ii) *House construction of which was begun after 1st April 1961 and completed between 1st April 1970 and 31st March 1978 (both the days inclusive)* : In these cases the special deduction allowable shall be a sum of Rs 1,200 per each residential unit or the amount of the annual value (after deduction of municipal taxes) whichever is less.

(iii) *Houses construction of which was completed between 1st April 1978 and 31st March 1982 (both days inclusive)* ; In such cases the special deduction allowable would be a sum of Rs. 2,400 per each residential unit or the amount of the annual value (after deduction of municipal taxes) whichever is less.

(iv) *Houses of which construction was completed on or after 1st April 1982* : In the case of such houses, the special deduction allowable in computing their annual value would be Rs. 3,600 per each residential unit or the amount of the annual value (after deduction of municipal taxes) whichever is less.

In case of residential units falling in the category (i) stated above, the new construction allowance is available for a period of three years from the date of completion of construction of the building. But in case of residential units falling *in any one of the other categories* viz (ii), (iii) and (iv mentioned above, the special deduction of new construction allowance is available for a period of five years from the date of completion of construction of the building.

It must, however, be noted that this allowance for newly built residential units would not be available in respect of houses which are occupied by the owner for purposes of his own residence.

The deduction envisaged in the second proviso to Section 23[1] is intended to encourage the construction of new residential units for the purposes of letting up. The second proviso to Section 23[1] which specifies the amount of deduction, depending upon the date of completion of construction, ends with the

words " so however" that the income in respect of any residential unit referred to in clause [a] or clause [b] or clause [c] or clause [d] is in no case a loss. These words mean that the deduction of Rs. 600/- or Rs. 1,200- or Rs. 2,400/- or Rs. 3,600/- as the case may be under clause [a] or clause [b] or clause [c] or clause [d] of the said proviso cannot be allowed in such a way as to yield a loss in respect of any residential unit referred to therein.

They do not mean that where the net result of the computation in respect of such residential unit (apart from the deduction of Rs. 600/- or Rs. 1,200/- or Rs 2,400/- or Rs. 3,600/- as the case may be) is a loss, such loss cannot be set off against other items of income under the same head or under any other head in terms of Sections 70 and 71.

In other words, it bars the allowance of the deduction under the second proviso to Section 23(1) deduction in respect of newly constructed units—in a case where the net result of the computation in respect of such property by virtue of deduction of municipal tax under the first proviso to Section 23(1) and the deductions admissible under Section 24—is already a negative figure. To put it differently, the question of allowance of the said deduction would arise only in ea case where the net income in respect of such residential units is not a loss. Wher the income in respect of such residential unit is likely to be a loss either by virtue of the allowance of the said deduction or by virtue of other deduction specified in Section 24, the question of allowance under the second proviso to Section 23(1) will not arise. It is significant to note that the Act does not bar the computation of a loss in the case of a newly constructed house property which is let out. It only bars the allowance of said deduction in a case where the income in respect of such unit is a loss: where the income in respect of such a unit arrived at, without allowing the special deduction, is a loss such a loss can be set off against income under the same head or other heads, in the same year in terms of Sections 70 and 71.

Other View :

There is also a view that in the case of newly constructed residential units coming within the scope of the second proviso to Section 23(1), the deduction under the proviso *should* be given effect to even though it might lead to loss in some cases and the loss if any in respect of such units will have to be ignored. This view does not appear to be correct.

Allowance for self-occupation : Where the house property is in the occupation of the owner for purposes of his own residence the annual value of the house after deduction of municipal taxes but without deducting the allowance for newly built residential units is to be reduced by a sum of Rs. 3,600/- (Rs. 1,800/- upto the assessment year 1982-83) or 50% of the annual value whichever is less Thus if the annual value after deduction of municipal taxes is Rs 8,000 the deduction in respect of allowance for self-occupation would be Rs. 3,600 but if the annual value is Rs. 2,000 the allowance in this regard would be restricted to Rs. 1,000. The amount arrived at after this allowance should be restricted to 10% of *total income*

of the owner from all sources other than self-occupied residential house (computed before allowing any deduction under Chapter VIA of the Act) If the annual value after deduction of the allowance exceeds 10% of such total income, the excess shall be disregarded. Thus if the annual value (after the above statutory deduction) is Rs. 3,000 and the assessee's total income from all other sources is Rs. 15,000 the adjusted annual value would be taken at Rs. 1,500 and the excess will be ignored. If on the other hand, Rs. 2,000 is the annual value and Rs. 40,000 is the income from all other sources, the adjusted annual value would be taken at Rs 2000 only.

In the case of self-occupied house property the owner is chargeable to tax on the notional income from the property represented by its annual value although he does not derive any real income from the property in the sense of rent received by a landlord from his tenant. The aforesaid concessional tax treatment for income from self occupied houses is intended specifically to reduce the hardship that would otherwise be caused to the assessee by taxing them on an artificial income. *With effect from 1 4.1976, this concessional tax treatment in respect of self-occupied houses is limited to only one house to be specified by the assessee.* Therefore if an assessee has more than one house and all of them are kept for purposes of his own residence the assessee will have to exercise his option and choose one house which he wants to be given the tax concession. After exercising the option the assessee should intimate his choice to the I.T.O. for purposes of assessment. The income from all other houses which do not qualify for this tax concession should be computed as if they are let out. Where a property is used by co-owners for self-residence each such co-owner will be individually entitled to the concessional treatment under Section 23 (2). This is made clear in the Explanation to Section 26.

Unoccupied residential house : Where the assessee owns *only one residential house* and is not in a position to occupy the same due to the requirements of his employment, business or profession at any other place and at that place he resides in a house not belonging to him, the annual value of the unoccupied house would be taken to be '*nil*' if it was not occupied for the whole of the year. If the property was occupied by the owner only for a part of the year, then the annual value of the property would be taken at a figure proportionate to the period of occupation. However, the income computed in respect of the property cannot in any case be assessed at a loss. If, as a result of the computation a loss is ascertained such a loss should be totally ignored. This tax concession in respect of unoccupied house is available only if the house is neither actually let out nor any other benefit is drived directly or indirectly by the owner therefrom. These provisions are contained in Section 23(3) read with Section 24 (2) the Act.

Deductions allowable (Section 24) : The adjusted annual value of the house property is taxable as income from the property after allowing the deduction in respect of the following items. Since the list of allowances specified in Section 24 is exhaustive, no other expenditure or loss such as licence fees, royalties, commission or charges for registration of the building and the tenancy agreement under the Rent Control Act would be a permissible deduction.

[illegible] actual expenses incurred on account of repairs, the [illegible] this deduction regardless of any sum being actually spent on repairs and regardless of the question of any vacancy of the building.

(2) **Insurance premium** : *The amount of any annual premium paid by the owner to insure the property against any risk of damage or destruction to it through any cause would be allowed as a deduction in full without any limits.*

(3) **Interest on mortgage** : *If the house property had been mortgaged solely for the purpose of raising funds and the funds have been wholly and actually utilised for acquiring, constructing, repairing or renovating the property* the interest on such mortgage is deductible in computing the income from the property. However, the Income-tax Officer is entitled to disallow deduction in respect of the interest payable if the mortgage is not genuine.

(4) **Annual charge** : Where the property is subject to an annual charge which is essentially the result of some legal obligations the amount of such annual charge is deductible in full. In order to be allowable as a deduction the annual charge should *not* be either (i) a charge created by the assessee voluntarily whether directly or indirectly, or (ii) a capital charge. Any tax levied in respect of the property or its income and payable to a local authority, the Central or State Government cannot, however, be treated as an annual charge for purposes of this deduction.

Annual charge involves two concepts (i) the annual liability to pay and (ii) the creation of an express or implied charge on the house property for the discharge of that liability. The distinction between an annual charge and capital charge would be clear from the following example. If a debt is charged on the property thereby entitling the lender to proceed against the property in the event of its non payment, it would be a capital charge; but if the interest payable on the loan is charged on the property or its income, then, that would be an annual charge. In other words, the annual charge is deductible only if it is a revenue nature. Therefore, a liability which in law is enforceable only by seizure and sale of the property would not constitute an annual charge and would not, therefore, be deductible. As annual charge implies a liablity of a recurring nature, a liability which does not so recur, would be a capital charge not deductible: If the liability represented by the charge on the property is of a capital nature, only the amount of interest thereon is deductible subject, however, to the provisions of Section 25 discussed below.

rent : Where the owner of the building is a lessee of the land building is constructed and as per the lease deed he has to pay the any other person any sum by way of ground rent in respect of the lease amount so paid or payable as ground rent would be allowable as . Where the ground rent is enhanced with retrospective effect, the tion allowable to the assessee is in respect of the entire amount of ground payable by him in the year in which the liability for the enhanced amount es. The tax authorities are not entitled to disallow the assessee's claim for duction on the ground that the amount relates to different years nor can they eopen the assessments of the earlier years for the purpose of allowing this enhanced deduction in those years

(6) **Interest on borrowings :** *Interest payable by the owner on moneys borrowed for the purpose of acquiring, constructing, reconstructing repairing, renewing, remodelling the property is deductible from the annual value in full. This deduction is allowable in all cases irrespective of the fact whether the principal or the interest is a charge on the property or its income or not. However, no deduction in respect of interest would be allowable from the annual value when the property itself is exempt from tax.*

With effect from the assessment year 1984-85, as a result of the amendments made by the Finance Act, 1983 any interest payable on borrowed capital utilised for the construction of acquistion of any property for any period shall be allowed as a deduction in five equal annual instalments. The first of such instalments shall be allowed in the previous year in which such house is constructed or acquired and each of remaining four instalments shall be allowed in four previous years immediately succeeding such previous year.

(7) **Land revenue and property tax :** Amounts actually paid by the assessee by way of land revenue (other municipal or local taxes) and any tax levied by the State Government in respect of the property would be deductible in full. The Madras High Court held in *C.I.T v. Dinrose Estate (1978) 111 I T R. 41*, the urban land tax levied by the State Government on the capital or market value of the vacant land in urban area would not be deductible in computing the income assessable under the head 'Income from house property',

(8) **Collection charges :** Any sum actually spent by the assessee for collection of the rent from the proverty is deductible from the annual value. The amount of deduction would be the amount actually spent by the assessee for this purpose of 6% or the adjusted annual value whichever is less. This deduction is allowable only in respect of the computation of income from houses let out but not the ones occupied by the owner for purposes of his own residence. Legal expenses incurred for recovering rents from tenants are to be treated under Executive Instructions as part of collection charges for the purpose of deduction.

(9) **Vacancy allowance :** In all cases where the house property which is *let out* remains vacant during a part of the year, a part of the adjusted annual value proportionate to the period of vacancy would be allowed as a deduction.

Where a property is let out in parts and any part of such let out portion was [illegible] the year, that portion of the annual value appropriate to [illegible] the period during which such part [illegible] [illegible] vacancy allowance. If the house is occupied by [illegible] as vacancy [illegible] residence no deduction would be allowable [illegible] his own residence no reduction is allowed in respect of a house [illegible] likewise no reduction [illegible] received by the landlord merely [illegible] let out and from which rent is received by the landlord merely [illegible] let out for some period such a vacancy is not because the tenant of the house had gone out for some period such a vacancy is not covered by this deduction. Therefore, the deduction in respect of the house is allowable only if the house is either not actually let out or the owner also does not occupy it.

The Explanation to Section 24 [I] [ix] makes it clear that the deduction in respect of vacancy allowance shall be granted irrespective of whether the period during which the property was vacant during the relevent year precedes or follows the period during which it is let out. Thus, even if the vacancy occurs before the house has been let out by the assessee deduction could be claimed under this provision.

(10) **Irrecoverable rents :** In cases where the property is let out, the amount of unrealised rent is deductible from the annual value in computing the income from house property. This deduction is allowable only if all the following conditions specified in Rule 4 of the income-tax Rules are fulfilled.

(i) The tenancy must be *bona fide*.

(ii) The defaulting tenant must have vacated the house or steps must have been taken to compel him to vacate the property.

(iii) The defaulting tenant should not be in the occupation of any other house property of the assessee.

(iv) The assessee must have taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or must prove to the satisfaction of I.T.O. that legal proceedings, even if taken, would be useless.

(v) The annual value of the property to which the unpaid rent related must have been included in the assessed income of the previous year during which the rent was due and tax should have been duly paid on such assessed income.

The proviso to Rule 4 provides that the deduction on account of unrealised rent cannot exceed the income chargeable under the head 'Income from house property" compute without taking into account any deduction in respect of unrealised rent.

If unrealised rent exceeds the income under the head "Income from house property" set off the excess amount can be claimed by the assessee in subsequent years till it is fully exhausted.

effect, such excess could be claimed as deduction in computing income the head, "Income from house property" in subsequent years. This the Supreme Court's decision in the case of C.I T. Vs. *Madhu Pal Jatia 105 I.T R. 179 [SC].*

The aggregate amount of all the permissible deductions in the case of an occupied residential house coming within the scope of Section 23 (3) should not, however, exceed the annual value of house [Section 23(3)].

Losses: If in any year the aggregate sum of the permissible deductions exceeds the annual value of the property there will be a 'loss' under this head. Such a loss could be set off under Section 71 against *income under any other head in the same year ; but the unabsorbed part of this loss cannot be carried forward for being set off against income in the subsequent years.*

***Amounts not deductible* (Section 25)**: The amount of annual charge or interest which would otherwise be deductible from the income from house property must be disallowed if the interest or annual charge, taxable as income under the Income tax Act in the hands of the recipient, is payable outside and (i) in respect of which tax has not been paid or deducted at source and (I) in respect of which there is no person in India who may be assessed as an agent or representative assessee under Section 163 of the Act. But these restrictions would not apply to any interest payable outside India on a loan issued for public subscription before 1st April, 1938.

Mr. Kashyap, a resident of Delhi gives the following account of particulars of his income during the financial year ended 31st March, 1984.

He owns two houses namely Prasanthi and Srinali. Prasanthi is occupied by Mr. Kashyap for his residence. The municipal value of Prasanthi is Rs 12,000. He spent Rs 3,000 for renovating the house in May, 1983. He paid Rs 1,200 towards municipal tax.

Construction of the second house Srinilai was completed on 31st March. 1983 It has been let out from 1st April, 1983 onwards. The house consists of five residental units Monthly rent receivable from each tenant is Rs. 500 p.m. The municipal value of the house is Rs. 20,000. Municipal taxes of Rs. 2,000 were borne by the tenants. Mr. Kashyap borrowed Rs. 1 lakh in April, 1981 at the rate of 15% interest from certain local bankers. He used the entire amount of borrowed money for the construction of the house. At the end of the financial years ended 1982-83 and 1983-84, he paid Rs. 30,000 and 50,000 towards the principal amount of loan. He paid interest due half-yearly on 30th September and 31st March regularly. During the financial year ended 31st March, 1984, he did not pay towards principal amount of the loan. He spent Rs. 500 for the collection of rent.

Mr. Kashyap made a taxable profits of Rs. 50,000 from his proprietary business during the year. Compute taxable income of Mr. Kashyap under the head 'Income from House Property' for the assessment year 1984-85.

Answer :

Computation of Income of Mr. Kashyap from House Property for the Assessment year 1984-85

(Financial year ended 31st March 1984)

		Rs.
Income from house 'Srinilai'		
Annual rental value (Rs. 500 x 12 x 5) Municipal value or rent receivable as annual rental value as per Sec. 23 (1) (b)]		*30,000*
Less : Municipal taxes (See note 1)		Nil
Annual value		30,000
Less : New Construction Allowance [Rs 3,600 per each residential unit or annual value whichever is less as per clause (d) of 2nd proviso of sub section (1) of Sec. 23]		18,000
Adjusted annual value (AAV)		12.000
Less : *Deduction under Sec. 24*	Rs.	
1/6th of AAV for repairs	2,000	
Collection charges	500	
Interest on moneys borrowed	8,100	
(See note 2)		
Aggregate amount of deduction under Sec. 24		10,600
Income from 'Srinilai'		1,400
Income from Prasanthi (Self-occupied house)		
Municipal value		12,000
Less : Municipal value		1,200
Annual value		10,800
Less : Self-occupation allowance [Rs 3,600 or 50% of annual value whichever is less as per Sec. 23 (2)]		3,600
Annual value		7,200

As per the proviso to Sec. 23 (2), annual value of the self-occupied house property shall be limited to 10% of total Income computed without including income from this property and without making deduction under chapter VIA of

the I.T. Act i.e. Rs. 5140 (10% of Rs. 1400 being income from Srinilai+Rs. 50,000 taxable profits from business).

Adjusted Annual Value		*5,140*
Less : Deduction under Sec. 24		
1/6th of AAV for repairs	*857*	*857*
(See Note 3)		
Income Srinilai		4,283
Taxable Income from House Property (Rs. 1400+Rs. 4283)		5,683

Notes : 1. No deduction is available for municipal taxes as they were borne by the tenants but not by the assessee.

2 As per the amendment made by the Finance Act, 1983 in Sec. 24 (1) (vi), interest on moneys borrowed payable during the period prior to the previous year in which the house is constructed is allowable as deduction in five yearly instalments commencing from such previous year. Hence the assessee is entitled for deduction of 1/5th of interest paid during the period prior to the previous year in which the construction of the house is completed i e. one fifth of the amount interest paid during the financial years ended 31st March, 1982 and 1983. Interest payable by the assessee during the relevant previous year is however deductible in full. Let us compute the interest deductible in the relevant previous year.

	Rs.
(a) Interest paid during 1981-82 @ 15% of Rs. 1 lakh	15,000
(b) Interest paid during 1982-83 @ 15% of Rs 70,000 (Rs. 1,00,000-30,000)	10,500
Interest paid prior to date of completion of construction.	25,500
1/5th of the amount of interest computed above is deductible during the relevent previous year	5,100
Add : Interest payable during the previous year @ 15% of Rs. 70,000−50,000)	3,000
Amount of interest allowable as deduction during the previous year	8,100

3. Under Sec. 24 (1) (i), deduction for repairs is allowed at the rate of 1/6th of annual value of the house property irrespective of the amount actually spent on repairs.

Self-Examination Questions

3 *The liability to tax in respect of the income from house property is* upon (a) the tenant, (b) the owner, (c) the mortgagee. (d) the lessee. ( )

34 The basis of charging income from house property is (a) the fair rent (b) municipal value (c) fair rent or actual rent which is higher (d) annual value. ( )

35 Income from house property which is held as a business asset or stock-in trade must be assessed as (a) income from business (b) income from other sources (c) income from house property (d) capital gains ( )

Income from house propetry occupied for purposes of the assessee's business or profession is (a) taxable under Section 22 (b) taxable under Section 56 (c) taxable as business income (d) not taxable since the house property in such a case is a depreciable asset. ( )

37 Since the liability to tax under Section 22 is based upon the ownership of the property, if the ownership of house is profitable the profits arising therefrom would be taxable as (a) business income (b) income from other sources (c) capital gains (d) income frome house property (e) not taxable at all. ( )

38 Where a house is owned by a partnership the assessment of the income from the property should be made on (a) the partners individually assuming that they are co-owners (b) the partner callectively, as an association of persons (c) the person from whom the property was acquired by the firm (d) the firm. ( )

39. The tax liabity in respect of income from property covers income from (a) leasehold buildings alone (b) buildings or lands appurtenant thereto (c) lands alone (d) super structure on the land represented by bulidings (e) freehold land bulidings. ( )

40. Income derived from letting out an entire business asset consisting of a whole jute mill must be assessed as (a) income from house property (b) income from business (c) income from profession (d) capital gains (e) income from other sources. ( )

41. Income derived by (i) a long term lessee (ii) short-tern lessee of a building by sub-letting or reletting the premises must be taxed as (a) business income (b) capital gains (c) property income (d) income from other sources. ( )

42. The ownership of property resulting in liability to tax is to be determined with reference to the (a) calendar year (b) financial year (c) assessment year (d) same year (e) financial year or accounting year any, followed by the assessee. ( )

43. Municipal taxes are deductible in computing the income from property (a) in full if the house was built before 1-4-1950 (b) to the extent of 5% if the house was built after 1.4.1950 in full if the house is let out

regardless of the date of its construction (d) in full in every case irrespective of the occupant of house or the date of its construction ( )

44. *Newly built* residential units qualify for special deduction from the annual value (a) in all cases (b) only if they are let out (c) only if they are occupied by the owner for the purpose of his own residence (d) only if they are mortgaged or leased out. ( )

45. The amount of deduction allowable in respect of new residential units shall not exceed –

(i) construction started after 1.4.1961 and completed before 31.3.1970. ( )

(ii) construction started after 1.4.1961 and completed after 31 3 1970 ( )
(iii) construction started after 1.4.1961 and completed after 31.3.1978 ( )
(iv) construction startad after 1 4 1961 and completed after 31.3 1982
(a) Rs. 500 (b) Rs. 1,200 (c) Rs 2,400 (d) Rs 600 (e) Rs. 3,600 per unit. ( )

46. The allowance for newly built residential unit is permissible for a maximum period of (a) 6 years (b) 3 years (c) 2 years (d) 8 years (e) 5 years. ( )
(i) for houses started after 31.3.1961 and completed before. 1 4.1978 ( )
(ii) for houses started after 31,3.1961 and completed after 1 4.1978 ( )

47. This allowance for newly built units is to be computed from the (a) date of completion of the building (b) end of the accounting year in which the construction was completed (c) end of the relevant assessment year (d) end of the financial year of completion. ( )

48. With effect from the assessment year 1984-85 buliding occupied by the owner for purposes of his own residence qualify for a deduction of
(i) (a) 4% (b) 25%(c) 60% (d) 50% of the annual value or
(ii) (a) Rs. 1,200 (b) 600 (c) Rs. 3,600 (d) 2,000 (e) Rs 5,000 whichever is less. ( )

49. The adjusted annual value of the house occupied by the owner for his own residential purposes must be limited to—
(a) 25% (b) 10% (c) 30% (d) 15% (e) 50% of the total income of the assessee from all sources other than such residential house. ( )

50. With effect from 1.4 1979 the concessional tax treatment for self-occupied residential houses is available for (a) maximum of two house (b) any number of houses (c) only one house (d) five houses. ( )

51. Where a property is used by co-owners for self-residence the concessional treatment in respect of self occupation will be given to (a) none (b) each such co-owner (c) any one of them. ( )

52. The deduction allowable in respect of repair of income from house property is a sum equal to — (a) [illegible] (b) 1/4th (c) 1/6th (d) 1/8th of the annual value.

53. The deduction in respect of repairs is allowable for (a) only those houses which are let out (b) only self-occupied residential houses (c) all houses even if the assessee had not spent any sum for repairs (d) all houses let out only for business or professional purpose. ( )

54. Expenses incurred on account of collection charges for realising the rent would be allowed as a deduction subject to a maximum of (a) 10% (b) 6% (c) 8% (d) 25% of the annual value. ( )

55. Vacancy allowance deductible in respect of houses let out is limited to (a) 1/4th (b) 1/6th (c) 1/8th of the annual value or (d) that part of the annual value proportionate to the period of vacancy.

56. Interest on mortgage of the property is deductible from the adjusted annual value (a) in all cases of mortgage (b) only in cases of English mortgage (c) in cases of mortgage where the moneys are used for the construction, reconstruction, repair or renovation of the building (d) in all cases of mortgage regardless of its purpose. ( )

Answers to Self-Examination Questions

1. (c) 2. (f) 3. (a) 4 (a) 5. (b) 6. (a) 7. (b) 8. (b) 9. (b) 10 (c) 11. (c) 12. (a) (d). 13. (i), (b), (ii), (d). (iii) (a), 14. (d) 15. (a) 16. (i). (c), (ii) (e) whichever is less. 17. (b). 18. (i) (b) (ii) (d) (iii). (a) 19. (d) 20 (d). 21. (b). 22. (d) 23 (d). 24. (c) 25. (c) 26. (a) 27. (b) 28. (d). 29 c) 30. (a) 31. (d) 32. (b) 33. (b), 34 (c) 35 (c) 36. (c) 37. (d) 38. (d) 39. (b). 40. (b) 41. (i) (c) (ii), 42. (e). 43. (d). 44. (b). 45. (i) (d) (ii) (b). (iii) (c) (iv). (e). 46. (e) (d) 47. (a) 48, (i), (d) (ii) (c), 49. (b), 50. (c), 51. (b) 52. (c), 53. (c) 54. (b) 55. (d) 56. (c).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL I S P. (N) I. Tax—5

INTERMEDIATE COURSE (N)

ELEMENTS OF INCOME-TAX LAW

STUDY—V

Profits and Gains of Business or Profession

This Study Covers :

1. Introduction.
2. Income chargeable under the Head 'Profits and Gains of Business or Profession'.
3. Computation of Income from Business.
4. Admissible Deductions.
5. Inadmissible Expenses/Payments.
6. Profits Chargeable to Tax.
7. Miscellaneous Provisions.

Prescribed Readings :

Sukumar Bhattacharya's *Indian Income-Tax Law and Practice*, Chapter XI.

H.C. Mehrotra's *Income-Tax and Accounts*, Chapters 9 and 10.

PROFITS AND GAINS OF BUSINESS OR PROFESSION (Section 28 to 44D)

1. **Introduction** : The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, or vocation carried on by him or on his behalf during the previous year. The term "business" has been so defined in Section .(1) of the Income-tax Act as to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". But the term "profession" has not been defined in the Act. It involves the concept of an occupation requiring either purely intellectual skill controlled by the intellectual skill of the operator. Such operation substantially consist of production or sale or making arrangements for the production or sale of commodities, *i.e.*, a trade or business activity. Thus a painter, a sculptor, an auditor, a lawyer, a doctor, a teacher, an architect, and even an astrologer are person who can be said to be carrying on a profession and not a business. The term 'profession' includes vocation as well [Section 2 (36)]. So far as chargeability of income under this head is concerned, it is not material whether a person is carrying on a 'business' or 'vocation' since for purpose of assessment under the Act, profits from all these three sources are treated and taxed alike.

The words used in the definition of the term 'business' given above have a wide connotation underlying each of them, but there is the fundamental concept of continuous exercise of an activity. Nevertheless, profits from even a single venture in the nature of trade would be assessable if the venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of development, divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on individual sales of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the plots and expenditure incidental thereto and has a surplus left.

Profits may be realised in money or in money's worth, *i e.* in cash or in kind. Where the profit is realised in any form other than cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this Section Payments voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or in the exercise of a profession or vocation. Thus any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

The gains of a trade are those which are gained by trading, their subsequent application being immaterial. Gains made even for the benefit of the community by a bublic body would also be liable to tax. To attract the provisions of Section 28, it is necessary that the business, profession or vocation should be carried on for some time during the accounting year but not necessarily throughout that year. It need not necessarily be carried on by the assessee owner personally, but should be under his direction and control. For example, if a

court intervenes and deprives the owner of the right to carry on his business and authorises someone else to carry on the business, the owner would not be chargeable to tax under this Section.

The charge is not on gross receipts but on profits and gains in their natural and proper sense, that is, in the sense which no commercial man would misunderstand. The real profits are ascertained on ordinary principles of commercial trading and commercial accounting The Act has not prescribed any method for their determination. Taxable income has, therefore, to be computed in accordance with the method of accounting regularly and consistently employed by the assessee. If no method of accounting has been regularly employed by the assessee or the method employed is such that income, profits or gains cannot be properly deducted therefrom, the income on such basis and in such manner as they deem fit. Likewise, it is not specified in the Act that an assessee must account for his receipts on the cash basis or mercantile basis: thereby the assessee has the right to follow any basis he chooses.

The Act, however, contains certain provisions for determining how the income is to be assessed. These must be followed in every case of business or profession The illegality of a business, profession or vocation does not exempt its profits from tax ; the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises when income arises to the assessee; the motive or purpose of earning the income is immaterial. Thus profit motive is not essential for describing the income for that activity as income from business or profession.

The profits of each distinct business must be computed separately, but the tax chargeable under this Section is not on the seperate income of every distinct business but on the aggregate of the profits of all the business carried on by the assessee Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession or vocation though such losses or expenses may not be expressly allowable *unless* the loss is either expressly or by necessary implication, disallowed by the Act under Section 30 to 43A

Income arising from business assets which are temporarily let out, *i.e*, an oil mill, cinema, theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as business income. But if the commercial asset is permanently let out, the income may be taxed as income from house property or income from other sources depending upon the circumstances.

2 Income Chargeable Under the Head 'Profits and Gains of Business or Profession' [Section 28] : The various items of income chargeable to tax as income from profits and gains of profession are as under :—

(i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.

Any compensation or other payment due to or received by—

(*a*) any person, by whatever name called managing the whole or substantially the whole of—(*i*) the affairs of an Indian company or (*ii*) the affairs in India of any other company at or in connection with th termination of his management of office or the modification of any terms and conditions relating thereto.

(*b*) any person by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto.

(*c*) any person for or in connection with the vesting in the government, or in any corporation owned or controlled by the government, under any law for the time being in force, of the management of any property or business.

(*ii*) Income derived by any trade, professional or similar association from specific services rendered by them to their members.

(*iii*) The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of any profession

The general principles of determining whether a certain receipt constitutes business income and whether a certain act would be treated as carrying on a business and the treatment of compensation received or termination of agency or other agreement have already been discussed. By taxing compensation received on termination of agency or on the take-over of management (which is a capital receipt) as income from business, Section 28 (ii) provides an exception to the general rule that capital receipts are not income taxable in hands of the recipient.

Similarly clause (*iii*) of Section 28 forms an exception to the general principles governing the assessment of income of mutual associations, such as chambers of commerce, stock brokers associations, *etc.* As a result, a trade, professional or similar association performing specific services for its members is to be deemed as carrying on a business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should be definitely or directly related to these services.

Of late, practice has been growing among professional men to secure some benefit or prequisite from their clients. *e.g* , an advocate from Bombay or Calcutta on his visit to Delhi to appear before the Supreme Court may be put up by the client at a luxurious hotel at his cost. If the relationship between the recipient of the benefit or perquisite and its giver was that of employee-employer or employee director, company, the value of such a benefit or perquisite would be taxable as "salaries' [Sections 15 and 17 (2) (*iii*).] But these provisions of law cannot be invoked to tax such a perquisite when provided to a professional man. On this account clause (*iv*) to Section 28 provides that the "value of any benefit", whether convertible into money or not arising from a business or the exercise of a

profession shall be treated as income chargeable to tax as profits and gains of business or profession.

According to explanation (1) to Section 28, the profits and gains of managing agency must be considered as profits and gains of a business in every case.

Speculation Business: Explanation (2) specifically provides that when a business is carried on in speculative transactions, that business of the assessee must be deemed as distinct and separate from any other business. This is because of the fact that there are separate provisions in the Act governing the treatment of profits and losses in such business.

According to Section 43 (5) the expression "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scrips. However the following three forms of transactions shall *not* be deemed to be speculative transactions:—

(*i*) contract in respect of raw materials or merchandise entered into by a person in the course of his manfacturing or merchandise business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him;

(*ii*) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and share through price fluctuations; and

(*iii*) a contract entered into by a mumber of forward market or stock exchange in course of any transactions in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as such number.

Thus, in all the cases, where actual delivery of transfer of the commodity or scrips takes place, the transaction would not amount to a speculative transaction, however highly speculative it may be in its nature. The actual delivery may be symbolic and includes delivery effected by mere transfer of delivery orders according to trade practice.

The three instances stated above constitute exceptions provided by the Act, whereby, certain transactions (*e.g.*, hedging contracts) entered into by manufacturers and merchants in the course of business to guard against the loss through price fluctuations, are excluded from the definition of speculative transactions. The provision should be liberally construed to cover not only hedging or forward contracts for purchase of goods but also such contracts for sale.

In this context, it may be pointed out that according to Explanation to Section 73 (which deals with losses in speculation business of purchase and sale of shares by companies which are not investment, banking or finance companies should be treated as speculation business. The result of this would be that losses from such dealing be set off only against gains from similar dealings in shares

6. Computation of Income from Business [Section 29]: According to Section 29 the profits and gains of of any business or profession are to be computed in accordance with the provisions contained in Section 30 to 40D. It must, however, be remembered that the specific allowances and deductions stated in these Sections are not exhaustive. The Act futher permits allowances of items of expenses under the residuary Section 37 (1). It has been added to extend the allowance to items of business expenditure not covered by other Sections, where these are allowable according to accepted commercial practice.

An item of loss or expenditure not falling within any of the express deduction may be allowed if it is deductible on ordinary principles of commercial accounting. Thus, in determining, whether a particular item (other than those covered by Sections 30 to 37) is deductible from profits, it is first necessary to inquire, whether the deduction is, expressly or by implication, prohibited by the Act and, then, if it is not so prohibited to consider whether it is of such nature that should be charged against incomings in a computation of the "profit and gains" properly so called. Accordingly, a loss due to embezzlement by an employee and a contractual liability to undertake a development scheme at a future date or allowable as deduction in computing the business profits without reference to any statutory provision for deduction. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though there is no specific provision in the Act allowing for such deductions. Examples of such losses are embezzlement, theft of cash in the business premises committed by a stranger, robbery, destruction of assets, overdrawing by employees, loss of stock-in-transit by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employee, *etc.* However, if a businessman, having business connection with a non-resident, is assessed as the agent of non-resident under Section 161 in respect of the non-resident's income and is unable to recover from the non-resident then amount of tax he cannot claim it as a bad debt or business loss incidental to the trade or under ordinary principles of commercial accounting as was held in *CIT. v. Abdullabhai Abdulkadar (1961) 41 I.T.R 545 (S C).*

But where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of the trade, any payment made as a result of such guarantee cannot be deducted as a business loss except in a case where the contract of guarantee is entered into in the course of business or pursuant to a trade or custom of which mutual accommodation is the essence, *e.g.*, traders standing surety for one another. When the exact amount of loss incidental to the trade cannot be proved by the assessee for reasons beyond his control, the amount of the loss may be estimated by the I T.O from such material as is available. In all such cases the loss allowable as incidental to the business must be the loss of current assets or stock-in-trade but not of capital asset. Thus, loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is under legal obligation or business necessity required to keep in the till would be allowable as losses incidental to the trade. Losses arising from payments made in advance to employees and moneys lent by the managed company to the managing agents which had become irrecoverable, would be deductible as being incidental to the business, provided the amounts paid in advance or as loan were so made with reasonable business prudence.

Loss caused by embezzlement is allowable as a deduction not necessarily in year in which the embezzlement takes place, but when there is no reasonable ...nce of obtaining restitution and the amount is found to be irrecoverable. Normally, when a businessman writes off the amount, it is *prima facie* an evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as a deduction in any year, are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

The Supreme Court held in *C I T. v. Piara Singh (1980) 124 I.T.R. 40 that where income from an illegal business is assessed to tax as such, the loss arising directly in the course of that business is deductible as business expenditure in computing the assessee's profit from that business.*

The allowances specified in Section 30 to 43A are disjunctive and cumulative and not alternative or mutually exclusive. The expenditure specifically covered by each Section must be dealt with under that Section and should not be claimed or allowed under any other Section.

In respect of wasting assets or on exhaustion of capital, no deduction is allowable from the income derived from such capital or wasting asset. Accordingly, where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of the annuity. Likewise in the case of a lease, the capital cost of the lease is not allowed to be deducted over the life of the lease.

At times, there can be a substantial difference between the book profits and those computed under the Act for purposes of assessment. It may be caused by disallowance of items of expenditure claimed as deductions by the assessee or by the allowance, in respect of certain capital expenditure, in accordance with the provisions of the Income-tax Act.

Compulsory Maintenance of Accounts

Under Section 44AA, effective from 1-4-1976, persons carrying on legal, medical, engineering or architectural profession or the profession of accountancy, technical consultancy or interior decoration or any other profession as may be notified by the C B D.T. in the offcial Gazette are required to maintain accounts *irrespective* of the quantum of their income receipts.

Persons carrying on *business* or any profession not specified above, are required to maintain accounts if their income from business or profession exceeds twentyfive thousand rupees or their total sales turnover or gross receipts, as the case may be, in business or profession exceeds Rs 2,50,000 in any one of the three years immediately preceding the previous year Inc ase of business or profession (not specifically covered) newly set up in any previous year, obligation to maintain accounts will arise if the income likely to exceed Rs. 25,000 or the total sales turnover or gross receipt, as the case may be, in business or profession are or is likely to exceed Rs. 2,50,000 during such previous year.

The C B D T. has got the power to prescribe by the rules the books of account and other documents to be maintained, the particulars to be contained therein, the form and the manner in which and the place at which they shall be kept and maintained and the period for which they should be kept and maintained or retained. In exercise of this power, the C.B.D.T. recently notified Rule 6F of the Income-tax Rules specifying the books of account and other dacuments to be maintained by certain professionals, the place at which they should be kept and the period for which they should be kept. Failure to maintain accounts in accordance with this provision will invite penalty under Section 271A.

4. **Admissible Deductions:** Let us now see the various items of expenses which are specifically allowed as deductions by the Act.

(A) Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30): This Section allows deductions in respect of the rent, rates, and insurance for building used by the assessee for purposes of his business, profession or vocation. However, where the premises are used partly for business, and partly for other purposes only a proportionate part of the expenses attributable to that part of the premises used for purposes of business, will be allowed as a deduction (Section 38), Where, the assessee has sublet a part of the premises, the allowance under this Section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this Section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is the owner of the premises and occupies them for his business purposes no notional rent would be allowed under this Section, for a person cannot be his own tenant. But, where, a firm runs its business in the premises owned by one of its partners, the rent payable to the partner would be an allowable deduction provided it is reasonable and is not excessive.

Apart from rent, this Section allows deductions in respect of expenses incurred on account of repairs to bulidings in cases where (*i*) the assessee is the owner of the building or (*ii*) the assessee is a tenant who has undertaken to bear the cost of repairs to the permises. Even if the assessee occupies the premises otherwise than as a tenant or owner, *i e*, as a lessee, licencee, mortgagee with possession, he is entitled to a deduction under this Section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purpose of the business or profession. Cesses, rates and taxes levied by a foreign government are also covered by the deduction under this Section. Where the premises in respect of which these expenses are incurred are not utilised wholly for the purpose of the business then the deduction allowable should be of an amount proportionate to the user of the premises for the purpose of the business.

(B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31): This Section allows deductions in respect of the expenses on current repairs and

and insurance of machinery, plant and furniture in computing the income business or profession. In order to claim this deduction, the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. Similarly, if the insured assets are used for the business of the assessee, the premiums payable would be allowed, even though, the payment may also ensure to the benefit of someone else. The deduction is allowable even if the assets in respect of which, the allowance is claimed are not owned by the assessee. But the important condition for the allowance is that the assets must have been used by the assessee in his own business during the previous year though not continuously. Thus insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset for a part of the accounting year the assessee is entitled to the deduction of the full amount of expenses on repairs and insurance charges and not merely an amount proportionate to the period of the use.

The term 'repairs' for purposes of this Section should be taken to include renewal or renovation of an asset but not replacement or reconstruction. Consequently, expenses incurred on renovation or renewal of an asset used for purposes of the assessee's business (but not the cost of replacing or reconstructing them) would be an allowable deduction. The deduction allowable under this Section is only of current repairs but not arrears of repairs for earlier year even though they may still rank for a deduction under Section 37 (1).

The deduction allowable in respect of premiums paid for ensuring the machinery, plant or furniture is subject to the following conditions : (*i*) the insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (*ii*) the assets must be used by the assessee for the purposes of his business or profession during the accounting year, and (*iii*) the premium should have been actually paid (or payable under the mercantile system of accounting).

The premium may take the form of contribution to a trade association which may undertake to indemnify and insure its members against loss ; such premium or contribution would be deductible as an allowance under this Section even if a part of it is returnable to the insured in certain events.

(*C*) *Depreciation* (Sections 32 and 34) : Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets. The allowance of depreciation, which is regulated by Rule 5 of the I T. Rules, is subject to the following conditions which are cumulative in their application.

(*a*) *The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture.* The depreciation in the value of any other capital assets cannot be claimed as a deduction from business income. No depreciation is allowable on the cost of the land on which a building is created because the term 'building' refers only to the superstructure but not the land on which it has been erected. The term 'plant' as defined in Section 43 (3) includes ships, books, vehicles,

scientific apparatus and surgical equipment. *The expression 'plant'* includes part of a plant (*e g*, the engine of a vehicle): 'machinery' includes part of a machinery and 'building' includes part of a building. However, the word 'plant' does not include a harbour bed, animals human body or stock-in trade. This plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability.

(*b*) *The assets should be actually used by the assessee for purposes of his business during the accounting year.* For this purpose it is enough if the asset is used at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year. Thus, even if the asset is used for a fraction of the year, the assessee would be entitled to the full amount of depreciation allowable at the prescribed rates.

However, in the case of a seasonal factory the full amount of depreciation would be allowed to the assessee provided the factory had worked at *any time* during the previous year. But if the assets are used not exclusively for business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. No depreciation allowance at the prescribed rates can, however, be granted for the accounting year in which the building, machinrry, plant or furniture ceases to be used for the business *i.e.*, when it is sold, discarded, demolished or destroyed [Section 34(2) (ii)].

Depreciation would be allowable to the owner in respect of assets which are actually worked or utilised by another person *e g.*, a lessee or licensee The deduction on account of depreciation would be allowed under this Section to the owner who has let out on hire his building, machinery, plant or furniture provided the letting out of such assets is the business of the assessee. In other cases, where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under Section 57 (ii), which we will study in the next Study Paper.

(*c*) *In order to be entitled to depreciation allowance the assessee must own the assets* : In the case of buildings the assessee must own the super structure and not necessarily the land on which the building stands and the lease-deed must provide that the building will belong to the lessor on the expiry of the period of lease. Thus no depreciation will be allowed to an assessee in respect of an asset which, he does not own but only uses or hires for purposes of his business. Further, no depreciation would be allowable in respect of any capital expenditure, which the assessee may be obliged to incur on the property belonging to others.

In the case of assets acquired on hire purchase system the allowance for depreciation would be granted as follows :

1. In every case of payment purporting to be hire-purchase production of the agreement under which the payment is made, would be insisted upon by the department.

2 Where, the fact on an agreement is that the ownership of the assets is at once transferred to a lessee the transaction should be regarded as one of purchase by instalments and consequently on deduction in respect of the hire amount should be made. For instance, this principle will be applicable in cases, where the lessor obtains a right to sue for arrears of instalments but has no right to recover the asset back from the lessee. The depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of the hire purchase agreement.

3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset the transaction should be regarded as one of hire purchase In such cases the periodical payment made by the hirer should for all tax purposes be regarded as made up of (*i*) the consideration for hire which will be allowed as deduction in assessment and (*ii*) payment on account of the purchase price to be treated as capital outlay and depreciation being allowed to the lessee on the initial value, namely, the amount for which the hired asset would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If however, the agreement is terminated either by outright purchase of the assets or by return to the seller the deduction should cease as from the date of termination of the agreement. For purposes of allowing depreciation, the assessee claiming deduction in respect of the assets acquired in hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished, the initial value of the asset should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per cent. For purposes of allowing depreciation, the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of the facts and circumstances of each case and terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name the mere fact that the payment of the price is spread over a specified period and is made in instalments to suit the needs of the purchaser does not disentitle the assessee from claiming the depreciation or investment allowance in respect of the asset, since the assessee would be the real owner although the payment of purchase price be subsequent to the date of the acquisition of the asset itself.

(*d*) *The assessee must furnish the prticulars prescribed in the form of return of income.* Failure on the part of the assessee to furnish fully and correctly the

... depreciation as prescribed in the return of ... to refuse deduction on account of depreciation.

... aggregate of all depreciation allowances including initial depreciation ... allowed to the assessee from year to year shall not in any case exceed the actual cost.

I Classification of Assets and Rates of Depreciation :

(From 84-85 assessment year) I Buildings

1	*General rate*	*5%*
2.	*Factory Buildings* excluding offices, godowns, officers' and employees' quarters, roads, bridges, culverts, walls and tubewell	*10%*
3	Purely temporary erections such as wooden structure	100%
4	For renovation or improvement the percentage as may be appropriate to the class of building in relation to which such renovation is effected.	
5.	For extension, the percentage as may be appropriate if the work constituted a separate building.	

II. Furniture and Fittings

General rate	10%
Furniture used in hotels, restaurants and boarding houses, schools, colleges and other educational institutions, libraries, welfare centres, meeting halls, cinema houses, theatres and circuses, hired furniture for functions.	15%

III Machinery and Plant

General rate	15%
Special rates	20%, 30%, 40%, 100%

Note : In respect of plant and machinery which can be classified as energy saving devices, the rate has been increased from 30% to 100%.

IV Ships

1. *Ocean going ships* —To be calculated on actual cost.

(i)	Fishing vessels with wooden hull.	10%
(ii)	other ships	5%

2. **Vessels ordinarily operating on inland waters :**

(i)	speed boats	20%
(ii)	other vessels	10%

Basis of Depreciation Allowance : Under Rule 5 and Part I of Appendix of the Income-tax Rules the depreciation allowable has to be calculated as a percentage of—

(*i*) the actual cost of asset in the case of ocean-going ships ; and

(*ii*) the written down value in the case of any other assets being, building, machinery, plant or furniture.

Written Down Value [Section 43 (6)]: In the case of assets acquired by the assessee during the accounting year that written down value means the actual cost to the assessee. *In the case of assets acquired during the accounting year, the written down value would be the actual cost of acquisition less the aggregate or all deduction actually allowed (and not only allowable).* For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43 (6) Explanation (3)] *If income is merely estimated and no depreciation is computed in any year,* depreciation cannot be said to have been actually allowed. In case, where a non-resident's total world income is computed after allowing full depreciation and a portion of such income is taxable as total income in India, only a proportionate part of the depreciation can be said to have actually been allowed.

In addition the Explanation added to Section 43 (6) has made the following provisions for the purposes of ascertaining the written down value

(*i*) When, in the case of a succession in business or profession as assessment is made on successor under Section 170 (2), the written down value of any asset shall be the amount which would have been taken as the written down value if the assessment had been made directly on the successor.

(*ii*) When any capital asset is transferred by a holding company to its subsidiary or *vice versa* then if the conditions specified in Section 47 (*iv*) or (*v*) are satisfied, the transaction not being regarded as a transfer, the written down value of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for its business purposes.

(*iii*) In a scheme of amalgamation, where any capital asset is transferred by the amalgamating company to the amalgamated company and the amalgamated company is an Indian company, the written down value of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.

Actual Cost [Section 43 (1)] : The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, as has been met directly or indirectly by any other person. The actual cost of an asset to the assessee is very important because: (*a*) the depreciation allowable in respect of ocean going ships is based upon actual cost ; (*b*) the written down value of any asset is to be calculated with reference to its actual cost ; (*c*) the aggregate of all depreciation allowable on an asset to the assessee has to

[illegible] to the actual cost of the asset. The actual cost of an asset to the assessee is the amount of capital expenditure incurred by him in respect of the [illegible], etc., of the asset and expenses incurred to put the asset [illegible] use in the business. For the purpose [illegible] have been incurred at the time of acquisition [illegible]. However, if a factory is shifted to a new site, the [illegible] cannot be treated as a part of its actual cost [illegible] would not qualify for depreciation. Where, the assessee [illegible] and, consequently [illegible] the original cost to the assessee would be the value at which [illegible] taken over by him and not the original cost of those assets to the previous owner of the business.

In addition the Explanations to Section 43 (1) provide the following bases for ascertaining the actual cost to an assessee.

(*i*) Where an asset is used in the business after it ceases to be used for scientific research related to that business and a deduction on account of depreciation in respect of that asset has been made earlier, the actual cost of the asset shall be taken to be actual cost of the assessee as reduced by any deduction allowed under Section 35 (1) (*iv*) in respect of that asset.

(*ii*) Where an asset is acquired by the assessee by way of gift, succession or inheritance the actual cost of the asset to the assessee shall be (*a*) the written down value thereof in the hands of the previous owner for the previous year in which the asset is so acquired or (*b*) the market value thereof on data of such acquisition whichever is less.

(*iii*) Where before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purpose of his business or profession and I.T O. is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability to income-tax by claiming depreciation with reference to an enhanced cost, the actual cost to the assessee shall be taken to be such an amount which the I-T O. may with the previous approval from the I A.C., determine having regard to all the circumstances of the case.

(*iv*) In the case of an asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reasen of any transfer or otherwise, is reacquired by him the actual cost to the assessee shall be (*a*) the actual cost to him, when he first acquired the asset *less* the depreciation actually allowed to him, as reduced by the loss deducted, *i e.*, terminal allowance, under Section 32 (1) (*iii*) or as the case may be, increased by any profit assessed as balancing charge under Section 41 (2) or (*b*) the actual price for which the asset is required by him, whichever is less.

(*v*) Where, a building which was previously the property of the assessee is brought into use for the purpose of the business or profession after 28-2 1946, the actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at rates

force on that date would have been allowable had the building been used for purposes of the business or profession since the date of its acquisition by the assessee.

(*vi*) When, any capital asset is transferred by a holding company to its subsidiary or by a subsidiary company to its holding company, then, if the conditions specified in Section 47 (*iv*) or (*v*) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its business.

(*vii*) *In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated company the actual cost of the transferred capital asset to the amalgamated company will be taken at the same amount as would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its business.*

Types of Depreciation Allowance: The depreciation allowable under this Section is of four kinds, *viz*., (*a*) Normal depreciation; (*b*) Initial depreciation; (*c*) Extra depreciation; and (*d*) Terminal depreciation. These are discussed below:—

(*a*) *Normal Depreciation*: The depreciation ordinarily allowable to an assessee in respect of his building, plant, machinery and furniture which are used for the purposes of his business, is known as normal depreciation and is calculated at the prescribed rates on the basis of the actual cost of the asset in the case of oceangoing steamers and on the written down value in the case of all other assets

Under Section 3 of the Act, length of the previous year in certain circumstances may exceed a period of twelve months, e.g., where the assessee changes the previous year in respect of a particular source of income from business and the I.T.O. prescribes a condition that in such a case the previous year for a particular assessment year will consist of a period in excess of 12 months. In such a case the amount of depreciation to which the assessee would be entitled to, is to be increased proportionately. In other words, if in a particular case the previous year consists of a period of, say 14 months and the depreciation calculated at the prescribed rates for an accounting period of 12 months is Rs. 24,000 the deduction to which the assessee is entitled on account of depreciation in respect of the previous year would be :—

$$\frac{14}{12} \times 24{,}000 = \text{Rs. } 28{,}000.$$

For ascertaining the written down value of the assets at the beginning of the next accounting year depreciation of Rs. 28,000 (and not merely Rs. 24,000) actually allowed to the assessee would be deductible from the actual cost or written down value (brought forward) of the assets

Machinery or Plant Acquired for Rs. 5000 or less; In respect of any *machinery or plant* (but not building or furniture) the actual cost of which does not exceed Rs. 5,000, the full amount of the actual cost of such machinery or plant

shall be allowed as a deduction by way of depreciation in the year in which the machinery or plant first used in the business or profession. Prior to the amendments made by the Finance Act 1983 with effect from the assessment year 1984-85, in respect of any machinery or plant the actual cost of which does not exceed Rs 750 the full amount of actual cost of such machinery or plant was allowed as deduction by way of depreciation in the year in which the machinery or plant is first put to use. Now the limit is **Rs** 5,000.

(*b*) *Initial Depreciation* (i) *Buildings used for low paid employees [Section 32 (1) (iv)]*. Under this provision initial depreciation is allowable in respect of certain buildings. All the following conditions must be fulfilled by an assessee in order to claim this initial depreciation.

(*i*) The building must be new.

(*ii*) The erection of the building must have been commenced and completed after 31-3-1961.

(*iii*) The building must be used by the assessee solely for the welfare purposes of the employees whose income chargeable under the head 'salaries' is Rs 10,000 per annum or less.

(*iv*) The building must be used by these employees as residence, hospital, crech, school, canteen, library, recreational centre, shelter, rest room or lunch room.

If all the above conditions are fulfilled the assessee would be entitled to a deduction by way of initial depreciation of a sum equal to 40% of the actual cost of the building. This deduction is allowable only in the first year in which erection of the building has been completed. It is to be noted that this sum of initial depreciation will not be deductible in determining the written down value of the building for the purpose of computing the normal depreciation.

It may be noted as per the amendments made by the Finance Act 1983 in Sec. 32 (1) (iv) initial depreciation allowed thereunder shall also be taken into account for determining written down value for the purpose of computing normal depreciation under Sec. 32 (1) (ii). This amendment shall be effective from the assessment year 1984-85.

(*ii*) *Building used for hotels [Section 32 (1) (v)]*

With effect from 1-4-1968. the provisions for allowing initial depreciation have been extended to new hotel building also. Accordingly, an amount equal to 25% of the actual cost of construction of the new building would be allowed as a deduction by way of initial depreciation. The conditions for the grant of initial depreciation in such cases are.

(*i*) The erection of the building must have been completed after 31st March, 1967.

(*ii*) The assessee should be an Indian company,

(*iii*) The company must be the owner of the building.

(*iv*) The company must use the building as hotel.

(*v*) The hotel should, for the time being, be approved by the government for this purpose.

(*vi*) The deduction is allowed only in respect of previous year in which the erection of the building is completed, or if the building is first put to use as a hotel in the immediately succeeding previous year, then the deduction is allowed in respect of that later previous year.

As a result of the amendment made by the Finance Act, 1983, with effect from the assessment year 1984-85 inital depreciation allowed under Sec. 32 (1)(v) shall be taken into account for determining written down value for computing normal depreciation allowable under Sec. 32 (1) (ii)

(*iii*) *Initial Depreciation in the case of certain Industries [Section 32 (i) (vi)].*

The provision of section 32 (i) vi) have not been discussed here in view of the fact that by virtue of the amendment made by the Finance Act, 1976 the scheme of investment allowance under Section 32 A has replaced the scheme of initial depreciation under Section 32 (i) (vi).

(*c*) *Extra Depreciation* :—Extra depreciation and extra shift allowance are allowable only in respect of *machinery and plant but not buildings or furniture.* The relevant provisions are as under :

Extra Depreciation (for hotels)

(*i*) The assessee must be an Indian Company.

(*ii*) The machinery or plant in respect of which this allowance is claimed must be installed in premises of the company used by it for running a hotel.

(*iii*) The hotel must be approved by the Central Government for the grant of development rebate at higher rates under Section 33.

(*iv*) The amount of extra allowance on account of depreciation shall be equal to 50% of the normal depreciation allowance. For this purpose normal depreciation allowance means the amount of depreciation allowance other than extra depreciation allowance or extra-shift depreciation allowance.

(*v*) The extra depreciation allowance to hotels will be available only for assessments commencing from 1-4-1970 or later.

Extra Shift Depreciation Allowance (for factories) :

(*i*) This allowance is available to all assessees.

(*ii*) It is allowable only, where the concern claims such extra shift allowance.

(*iii*) The assessee can claim the allowance only if he works on the machinery or plant in shifts.

(iv) The amount of allowance should be in proportion to the number of days for which the factory has worked in shifts during the previous year which bears to the normal working days in the previous year.

For this purpose the normal number of working days for the previous year has been fixed at 240 days or the actual number of days for which the concern has worked, whichever, is higher. However, in the case of a seasonal factory or concern it would be 180 days or the number of days on which the factory has actually worked during the previous year, whichever is higher.

For example, if a non-seasonal factory has worked 270 days during the previous year out of which it worked triple shift on 135 days and double shift on 90 days the extra depreciation allowance for triple shift working will be 130/270 *i.e.*, one-half of the normal allowance and that for double shift working 90/270 *i.e.* one-third of one-half or 1/6th of the normal depreciation allowance

(v) The maximum amount of extra-shift allowance shall be restricted to (a) an amount equal to 50% of the normal depreciation allowance in the case of double shifts and (b) an amount equal to the amount of normal depreciation allowance in the case of triple shifts.

(vi) In both the cases the assessee must establish to the satisfaction of the I.T.O. that the factory has worked double or triple shifts for the required number of days.

(vii) No extra-shift allowance shall be allowed in respect of any item of machinery or plant which has been specifically excluded by the inscription of letters, "N.E.S A." (meaning No Extra Shift Allowance) against it and also in respect of certain other items of machinery specified in Part I of Appendix I to the Rules.

(d) *Terminal Depreciation [Section 32(i) (ii)]* : The provisions for following terminal depreciation or balancing allowance are as under.

(i) It is allowable in respect of any building, machinery, plant or furniture used by the assessee for purposes of his business.

(ii) It is allowable in the accounting year in which the asset is sold, discarded, demolished or destroyed.

(iii) The sale, destruction or demolition of the asset should take place in a previous year *later* than the year in which the asset was first brought into use by the assessee. In other words, if the asset is sold, discarded or demolished in the same year in which it was first put to use, the assessee would not be entitled to any allowance on account of terminal or normal depreciation. Each discarded item must be considered separately for the purpose although the amounts allowable in respect of each item are aggregated to ascertain the amounts allowable. In respect of an asset which is wholly or partly destroyed, the allowance can be granted only for that previous year in which the property has been actually sold, discarded, destroyed or demolished, whichever is the earliest.

(*iv*) The amount of allowance—(*a*) in respect of property which is sold is the excess of written down value over the amount of sale price: (*b*) in respect of property discarded, demolished or destroyed it is the excess of the written down value over the amount received in respect of insurance, salvage or compensation moneys together with the amount of scrap value, if any.

(*v*) The amount of deficiency which is allowable as terminal allowance must be actually written off in the books of assessee in order to claim this deduction The word 'sold' as used in this connection not only means the actual sale of the asset but also includes a transfer by way of exchange or compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company.

In order to qualify for this allowance the business in the course of which the asset relating to terminal depreciation has been used must be carried on during the accounting year in which the assessee is entitled to this deduction. If the business had been discontinued earlier, the deduction cannot be claimed against the income from another business carried on by the assessee even if the discarded assets are used at their discarded value in the other business carried on by the same assessee.

Depreciation on Motor Cars: With effect from the assessment year 1975-76 no depreciation will be allowed in respect of any motor car manufactured *outside India* acquired by the assessee after 28th February, 1975, if used otherwise than in a business of running it on hire for tourist. Simultaneously, the tax payers will be entitled to depreciation allowance with reference to the *full cost* indigeneously manufactured motor cars, where such cars are acquired after 28th February, 1975.

Depreciation on Rented Buildings [Section *33* (*1A*]: In cases, where an assessee incurs, at any time after 31-3-1970, any expenditure of a capital nature on any structure of work constructed or done by him or in relation to, or by way of renovation or extension or improvement to any building held by him under a lease or other right to occupancy and used for purpose of his business or profession, he will be eligible for the grant of depreciation allowance on such capital expenditure at the rates specified in the Income-tax Rules. This allowance, however, is not available in respect of expenses incurred (*i*) in the year of termination of the lease or right of occupancy [Section 34(2)(iii) or (ii) for the year in which deduction of such expenses is allowed under Section 15(2) (iv), *i.e*, capital expenditure incurred for scientific research. The assessee will have the right to claim terminal depreciation on the termination of the lease of right of occupancy if the compensation money received in respect thereof is less than written down value. Likewise, if the compensation money is higher than the written down value the assessee will be liable to balancing charge [Sections 41 (2A) and 59] The above provisions will apply, as far as may be to the computation of income from other sources for the calculation of depreciation allowable under Section 57.

Additional Depreciation in respect of New Machinery or Plant in Certain Cases: *With a view to stimulating investment during the new five-year plan period, the Finance (No. 2) Act, 1980 has inserted a new clause (iia) in sub section* (1) of Section 32 to provide for a further deduction by way of *additional depreciation* in respect of new machinery or plant installed in certain cases. The provisions are effective from 1st April, 1981 and will accordingly apply in relation to the assessment year 1981-82 and onwards. The salient features of this additional depreciation allowance are explained briefly:—

(*i*) The additional depreciation will be admissible in respect of *new* machinery or plant installed after 31st March, 1980 but before 1st April, 1985. For this purpose, the expression "new machinery or plant" will have the same meaning as in clause (2) of the Explanation below clause (vi) of Section 32(1) and accordingly, include second hand machinery or plant imported from the foreign country, if the following conditions are fulfilled, *viz.*,

(*a*) Such machinery or plant was not at any time prior to the date of its installation by the assessee used in India.

(*b*) Such machinery or plant is imported into India from any counrty outside India.

(*c*) No deduction on account of depreciation in respect of such machinery or plant is allowed is or allowable under the provisions of the 1922 Act or 1961 Act computing the total income of any person for the period prior to the date of the installation of the machinery or plant by the assessee.

(*ii*) No additional depreciation allowance will be admissible in respect of ships, aircraft, road transport vehicles, office appliances or machinery or plant installed in any office premises or residential accommodation including any accommodation in the nature of a guest house. For this purpose, residential accommodation does not include premises used as a hotel. Machinery or plant in hotels will, therefore, qualify for deduction on account of additional depreciation, if other conditions laid down in this behalf are fulfilled.

(*iii*) Additional depreciation will not be admissible in respect of any plant or machinery, the whole of the actual cost of which is allowed as deduction whether by way of depreciation or otherwise in any one previous year.

(*iv*) The additional depreciation will be allowable only in respect of the previous year in which the machinery or plant is installed or if the machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year. It should be carefully noted that this additional depreciation will be admissible only in one year, *i e*, in the year of installation or if the machinery or plant is first put to use in the immediately succeeding previous year, then, in respect of that year.

(*v*) The quantum of additional depreciation will be equivalent to 50% of the normal depreciation allowance excluding extra-shift allowance and the extra allowance in respect of machinery or plant installed in any premises used as a

hotel. Thus. where the assessee is entiled to depreciation allowance @ 10% in respect of certain machinery and plant and also to extra-shift allowance on account of double or multiple shift working of the machinery or plant, depreciation allowance will be 5% of the actual cost of the machinery or plant.

(*vi*) Additional depreciation allowance will be taken into account in determining the written down value of the machinery or plant for subsequent year. And accordingly. it will be taken into account in calculating the balancing charge in determining the profit under Section .41 (2). The aggregate of additional depreciation and normal depreciation including multiple shift allowance over the years will also not exceed the actual cost of the qualifying machinery or plant.

(*vii*) Additional depreciation will not be admissible if the machinery or plant is sold, discarded, demolished, destroyed in the previous year.

(*viii*) Where the machinery or plant is not exclusively used for the purpose of the business or profession, the additional depreciation as in the case of normal depreciation will be restricted to a fair proportionate part which the Income-tax Officer may determine having regard to the user of such machinery or plant for the purposes of the business or profession.

(*ix*) The provisions of Section 32(2) relating to set off and carry forward of depreciation allowance shall apply in relation to additional depreciation admissible under the new clause (iia) of sub-section 32 (1) as they apply in relation to normal initial depreciation allowance admissible under clauses (i), (ii), (iv), (v) and (vi) of the Section.

Set-off and Carry Forward of Depreciation : Unabsorbed depreciation has been treated in the same way as any other business losses with an important difference, *i e*, there is no time limit for the carry forward and set off of unabsorbed depreciation. If the profits of a particular business are not sufficient to absorb the depreciation allowable under this Section, the allowance can be set off against profits of any other business. If there are no business profits chargeable to tax or if the profits of all the business taxable under the head business or profession, are insufficient to cover the depreciation allowance, the amount of the allowance may be set off against income under any other head for the year. If still some part of the depreciation allowance remains unabsorbed, it may be carried forward and set off against income of the succeeding year under any head without any time limit Where the amount is recomputed in reassessment, the assessments for the succeeding years to which the depreciation from any earlier year is carried forward may be amended as a rectification of mistake under Section 155 (4). Where the assessee is a registered firm or an unregistered firm treated as registered the above principles will apply in respect of the individual assessment of its partners also. However, the assessee is not entitled to carry forward the unabsorbed depreciation from time to time, when once the business to which the depreciation relates has been discontinued and the asset is no longer used by the assessee for the purpose of any business of carrying on some activity the income from which is taxable as 'income from other sources'. The unabsorbed depreciation allowance cannot also be assigned to the tranferee of the business

even if the transfer is made under a scheme of 'amalgamation' as defined in Section 2 (1A) and consequently the transferee of a business cannot carry forward or set off the unabsorbed depreciation attributable to the period prior to the transfer. However, the cases falling under the scope of the new Section 72A constitute exception to this rule.

Disallowance of Depreciation: Under Section 40 A (5) (a) (ii) the depreciation allowable to any assessee in respect of an asset used by an employee either, wholly or partly, for his own purposes or benefits should not exceed the limits specified in this clause. The benefits or perquisites (including depreciation on assets used by them) granted to an employee in excess of the limits stated therein, are not deducible from the incomes of the employer.

In the case of a company, Section 40 (c) further provides that in case, where the assets are used by a director or a person having substantial interest in the company or a relative of the director of such a person, wholly or partly, for his own purpose or benefit, the depreciation allowance would be granted only to the extent to which the allowance, in the opinion of the I. T. O. is not unreasonable or excessive having regard to the legitmate business needs of the company and the benefits derived by or accruing to it therefrom.

(D) **Investment allowance** : The Finance Act, 1976 has inserted a new Section 32A, with effect from 1-4-1976. The new Section provides for a scheme of 'Investment allowance', for certain priority industries The scheme has replaced the initial depreciation that was available under Section 32 (1) (vi) The investment allowance is similar to the development rebate in many respects However, there are certain points of distinction between the investment allowance and the development rebate. The provisions regarding withdrawal of the investment allowance in certain circumstances, continuation of allowance on amalgamation, etc , generally follow the provisions relating to development rebate. The characteristic feature of the investment allowance are explained below :

1. This Section provides for the deduction in the computation of taxable profits of sum by way of investment allowable in an amount equal to 25 per cent of the actual cost of new machinery or plant (other than office appliances or road transport vehicles) *installed after 31st March, 1976.*

With effect from assessment year 1978-79, the benefit of Investment Allowance is available in respect of new machinery or plant installed in all industries except low priority industries listed in the new Eleventh Schedule.

2. A small-scale industrial undertaking is also entitled to investment allowance in respect of new machinery or plant installed by it, irrespective of the consideration, whether or not it manufactures or produces articles or things specified in the Eleventh Schedule.

An industrial undertaking would be deemed to be small scale industrial undertaking if the aggregate value of the machinery and plant owned and installed by the assessee as on the last day of the previous year, (and in the case

of hired machinery or plant, the actual cost thereof as in the case of the owner of such machinery or plant) does not exceed Rs. 10,00,000. As a result of the amendments made by the Finance Act, 1981. with effect from Assessment year 1981-82, the above limit of Rs 10 lakhs would be increased to Rs. 20 lakhs in a case where the previous year ends after 31st July, 1980. For this purpose, plant and machinery does not include tools jigs, dies and moulds. The value of the machinery owned by the assessee is the actual cost thereof and in the case of hired machinery or plant the actual cost thereof to the owner of such machinery would be treated as the value of the machinery of the small-scale industrial undertaking.

Small-scale industrial undertakings remain eligible for investment allowance even if they are engaged in the manufacture of low priority items listed in the Eleventh Schedule to the Income-tax Act. Central Government is empowered to add new items to the list of low priority industries in the Eleventh Schedule. The benefit will not be allowed to such newly listed industries in respect of plant and machinery installed one year after the date of notification.

With effect from the assessment year 1984-85 investment allowance shall be granted in respect of any new machinery or plant installed *on or after 1st April 1983* but not later than *31st March, 1988* for the purposes of *business of repairs* to ocean-going vessels or other powered craft. It is provided that this benefit can be availed of only if the business is carried on by an Indian company and such business is approved for the time being by the Central Government in this behalf.

3. The new clause (2A) seeks to ensure that if a plant or machinery is *mainly* installed for the purpose of industries covered by Section 32A, the benefit will *not* be denied if such plant or machinery is *also* used partly for manufacture or production of articles listed in the new Eleventh Schedule.

4. Investment allowance at a higher rate of 35% would be available under Section 32A (2B) in respect of new plant and machinery installed on or after 1-7-1977 but before 1-4-1987 for the purpose of manufacturing any article or thing by using know-how developed in Government laboratories, public sector companies, Universities or other institutions which are recognised in this behalf by the prescribed authority. The prescribed authority for this purpose is the Secretary Department of Science and Technology, Government of India. The benefit could be claimed only if the assessee has acquired the right in respect of the technology or know-how and furnishes the requisite certificate from the prescribed authority. Such plant and machinery should not, however, be used for manufacture of any of the items listed in the Eleventh Schedule. This condition is applicable in the case of both small-scale industrial undertakings and other undertakings.

As per new clause (2C) inserted by the Finance Act, 1983 investment allowance shall be granted at the rate of '35 per cent' in respect of any new machinery or plant which would assist in the control of pollution or protection of environment. This benefit can be claimed subject to satisfaction of two conditions viz. (i) such plant and machinery has been notified in this behalf by the Central Government in the Official Gazette and (ii) such plant and machinery is installed in an

industrial undertaking which can claim investment allowance under Sec 32A This amendment shall be effective from the assessment year 1984 85.

5. The investment allowance will also be admissible in respect of new ships or new aircraft acquired after 31st March, 1976, by a taxpayer engaged in the business of operation of ships or aircraft. Second-hand ships or aircraft which were not previously used by any person resident in India, reconditioned machinery or plant imported from abroad will also qualify of grant of investment allowance subject to certain conditions.

6. The allowance is *not* available in respect of office appliances or road transport vehicles. Machinery or plant installed in an office or a residential accommodation including a guest house would not be eligible for the investment allowance.

7. The allowance will be available in respect of a new ship or an aircraft or a new machinery or plant which is *owned* by the assessee and *used* for the purposes of the business carried on by him.

8. Ships, machinery or plant in respect of which development rebate is allowable under Section 33 will not be eligible for investment allowance.

9. If the whole of the actual cost of the machinery or plant is allowed as a deduction in a single previous year, whether by way of depreciation or otherwise, investment allowance cannot be claimed. For example, capital assets used for scientific research would not be eligible for the investment allowance since the actual cost of such assets is deductible in one previous year.

10. The prescribed particulars have to be furnished in order to be eligible for the investment allowance.

11. The deduction on account of investment allowance would be allowed in respect of the previous year in which the ship or aircraft was acquired or machinery or plant was installed or if the ship, aircraft, machinery or plant is first put to use in the immediately succeeding previous year, then in respect of that previous year.

12. The deduction is made from the total income of the assessee. The 'total income' for this purpose denotes income *after* deduction of development rebate and development allowance, wherever, applicable, but *before* making deduction under Section 32A in respect of investment allowance or under Chapter VI-A (deductions from gross total income). Where the total income as computed above is not adequate to absorb the entire investment allowance, such allowance as cannot be absorbed can be carried forward for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year in which the machinery or plant was installed or the ship or aircraft was acquired or, as the case may be, the immediately succeeding previous year, if put to use in a subsequent year.

13. An amount equal to 75 per cent of investment allowance to be actually allowed has to be debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account called "Investment Allowance Reserve Account." In the case of ships, a reserve of only 50 per cent of the amount to be actually allowed is required to be created. The reserve must be utilised before the expiry of the period of 10 years next following the previous year in which the ships or aircraft was acquired or the machinery or plant was installed, to acquire a new aircraft to new machinery (*other than* those machinery or plant in respect of which investment allowance is not available) for the purpose of the business of the assessee. Until a new asset is acquired, the reserve can be utilised for the purpose of the business *other than* for distribution by way of dividends or profits or for remitting outside India or for the creation of any assets outside India.

The deduction in respect of investment allowance shall *not* be denied by reason *only* that the amount debited to the profit and loss account of the relevant previous year and credited to the Investment Allowance Reserve Account exceeds the amount of the profit of such previous year (as arrived at without making the debit on account of investment allowance), in accordance with the profit and loss account.

Where an Income-tax Officer makes a higher assessment of income than what is shown in the return and consequently higher investment allowance becomes deductible, the Income tax Officer has to give a notice in writing to the assessee and give him an opportunity to credit within the time specified in the notice a further amount to the reserve account.

14. The ship, aircraft, machinery or plant has to be retained for a period of at least eight years by the assessee. The asset should not be sold or otherwise transferred by the assessee to any person at any time before the expiry of eight years from the end of the previous year in which it was acquired or installed. However, this condition shall not apply (*a*) where a ship, aircraft, machinery or plant is sold or otherwise transferred by the assessee to the government, a local authority, a corporation established by a Central, State or Provincial Act or a Government Company or (*b*) where the sale or transfer of the asset is made in connection with the amalgamation of two companies or succession of a partnership firm by a company.

However, in cases of amalgamation, the amalgamation should be one which falls within the meaning of the definition in Section 2 (1A) and the amalgamated company must continue to fulfil the conditions regarding reserve and retention of the concerned asset. Only if these conditions are satisfied, the amalgamated company would be entitled to the allowance on account of investment allowance or the carry forward and set-off of unabsorbed investment allowance in the same manner and to the same extent as the amalgamated company would have been entitled.

In the case of succession of a firm by a company, all the properties and liabilities of the firm relating to the business immediately before succession should become the property and liabilities of the company and all the shareholders of the company must have been the partners of the firm immediately before succession,

15. If the asset is transferred in violation of the conditions given above (Point 14) or the utilisation of reserve does not comply with the conditions given in Point 13 above the investment allowance given earlier to the assesee would be deemed to have been wrongly allowed to the assessee resulting in a mistake apparent from the records and the assessment will be amended under the provisions of the newly inserted sub-section (4A) of Section 155.

(F) **Development Rebate (Sections 33 and 34):** The provisions of Section 33 granting deduction on account of development rebate have got only academic importance now in view of the fact that the rebate is withdrawn for all practical purposes. The provisions have, therefore, not been explained in detail. Development rebate was being granted in respect of new ships, new machinery or plant as well as second hand ship or machinery or plant satisfying certain specified conditions. The allowance was subject to the conditions laid down in Section 34(3) regarding creation of development rebate reserve and its non-utilisation for certain prohibited purposes and non-transfer of assets in respect of which development rebate was allowed, for a specified period of time. Violation of the conditions laid down in Section 34(3) would *involve* withdrawal of the developmental rebate allowed earlier. Though the rebate as such is not available now, the continued compliance of such conditions *might* be necessary even now, in cases where the specified period has not expired. For instance, one of the conditions which governed the grant of development rebate was that the assessee should have created a development rebate reserve of an amount equal to 75% *or more* of the development rebate actually allowed by debiting the Profit and Loss Account and crediting to a Reserve Account. The reserve so created should not be utilised for a period of eight years (*a*) for distribution by way of dividends *or* profits; (*b*) for remittance outside India as profits; or (*c*) for creation of any asset outside India; or (*d*) for any other purpose which is not the purpose of the business of the undertaking. However, this requirement in respect of creation of development rebate reserve did not apply to certain special cases

Another condition required that the asset should not be said or otherwise transferred by the assessee to any person at any time before the expiry of *eight* years from the end of the previous year in which it was acquired or installed. If the asset is transferred in violation of this condition the development rebate would be treated as having been wrongly allowed to the assessee resulting in a mistake apparent from the records which will be rectified under Section 155(5). However, this condition shall not apply (*a*) where the ship has been acquired or machinery or plant installed before 1.1.1958; or (*b*) where the ship, machinery or plant is sold or otherwise transferred by the assessee to the Government, a local authority a corporation established by a Central, State or Provincial Act or a Government company; or (*c*) where the sale or transfer of the asset is made in connection with the amalgamation of two companies or succession of a partnership firm by a company referred to in sub-section (3) or (4) of Section 33. Violation of the above conditions regarding utilisation of development rebate or the retention of the concerned asset would leave to amendment of concerned assessment in which the allowance was granted and withdrawal of such allowance was granted and withdrawal of such allowance under Section 155(5) treating it as a case of wrong allowance given to the assessee resulting in a mistake apparent from the records.

(F) Development Allowance (Section 33) : Development allowance is similar to the development rebate and has been introduced with effect from 1.4.1965 with a view to encouraging the development and modernisation of tea industry. Development allowance differs from development rebate in the following respects :

(*i*) Development allowance is allowable only in the case of assessee carrying on the business of growing and manufacturing tea in India whereas development rebate was allowed to all assessees carrying on business.

(*ii*) Development allowance is granted on the basis of actual cost of planting or replanting tea bushes ; but development rebate was allowed on the actual cost of the machinery or plant of the assessee.

(*iii*) The rates of development allowance are different from those for development rebate.

(*iv*) Development allowance is allowed at two stages whereas development rebate was allowed only at one stage being the year of acquisition of the ship or installation of the manhinery or plant or the immediately succeeding year, if it was first put to use in the later year.

For the purpose of this development allowance, a taxpayer who carries on the business of growing and manufacturing tea in India will be entitled to claim development allowance even in respect of tea bushes planted on land in respect of which he holds any lease or other right of occupancy.

Except for these differences the conditions for granting development allowance and the provision relating to carry forward and set-off of unabsorbed development allowance are broadly similar to those for the allowance of development rebate.

In order to qualify for deduction by way of development allowance (*i*) the planting of tea bushes must have commenced after 31.3.1965 in the case of new plantations and (*ii*) the planting should have commenced after 31.3.1965 and completed *before* 1.4.1970 in the case of tea bushes which have been planted in replacement of those which have died or have become permanently useless.

Further, Rule 8A of the Income-tax Rules, 1962 specifies the following conditions for purposes of granting development allowance.

(*i*) The assessee must at least three months prior to the commencement of operations for planting or replanting tea bushes, give a notice to the Tea Board of his intention to do so in Form No. 4.

(*ii*) The assessee must afford the Tea Board or such other person or agency as may be authorised in writing by the Tea Board in this behalf, every reasonable facility to enter upon and inspect the area under planting or replanting, as the case may be.

(*iii*) The assessee shall furnish to Tea Board such particulars, documents of statements in relation to the planting or replanting of tea, as the Tea Board may require him to furnish,

(iv) The assessee must furnish to the I.T.O along with his return of income for the previous year in respect of which the deduction is claimed, certificate from the Tea Board in Form No 5 and a statement of particulars in Form No. 5A.

Rates of Development Allowance

		Percentage of Actual Cost of Planting
(*i*)	If the tea bushes are planted on virgin soil (*i e.*, land not planted at any time with the bushes).	50
(*ii*)	If the bushes have been planted on land previously abandoned.	30
(*iii*)	If the tea bushes are planted in replacement of those which have died or become permanently useless, on any land already planted with tea bushes (*i e.*, replantation)	30

For the purposes of calculating the development allowance the expression 'actual cost of planting' means the aggregate of –

(*i*) the cost of preparing the land :

(*ii*) the cost of seeds, cutting and nurseries :

(*iii*) the cost of planting and replanting; and

(*iv*) the cost of upkeep therefor for the previous year in which the land has been prepared and the three accounting years immediately succeeding such previous year.

In order to ascertain the actual cost of planting to the assessee, the aggregate of all the four items of cost must be reduced by that portion of the cost, if any, as has been met directly or indirectly by any other persons or authority. However, if the actual cost of planting arrived at as aforesaid exceeds the below mentioned ceiling limits, such excess would be ignored. It may be noted these limits have come into force on 1-4-1982

(*i*) For tea gardens situated in the plains – Rs 30,000/-.

(*ii*) For tea gardens in hilly areas other than Darjeeling District —Rs. 35,000/-.

(*iii*) For tea gardens situated in the hilly areas of the District of Darjeeling —Rs. 40,000/-.

Two Stages ; The deduction on account of development allowance is allowed in two stages.

First Stage : The development allowance will, in the first instance, be computed with reference to the portion of the actual cost of planting which is

incurred in the accounting year in which the land is prepared, and the am unt so computed will be allowed as deduction in respect of such accounting year next following.

Second Stage: The development allowance will again be computed at the end of the fourth year period with reference to the cost of planting and if the allowance so computed exceeds the allowance already deducted in respect of the second year, as aforesaid, the amount of the excess will be allowed as a deduction in respect of the fourth accounting year reckoned from the year in which the land is prepared for planting or replanting, as the case may be.

Order of Priority for Various Allowances ; The combined effect of the provisions of Sections 32, 32A, 33, 33A, and 72 is that in the nature of depreciation allowance, investment allowance, development rebate, development allowances and losses, such allowances and losses would be deductible in the order given below, in cases where the profits are insufficient to absorb all of them :

(*i*) Current depreciation [Section 32(1)].
(ii) Brought forward business loss of earlier years [Section 72(1)].
(iii) Unabsorbed depreciation of earlier years [Section 32(2)].
(iv) Unabsorbed development rebate of earlier years [Section 32(2)(ii)].
(v) Current development rebate [Section 32(2) i)],
(vi) Unabsorbed development allowance of earlier years [Section 34A(2)ii]
(vii) Current development allowance [Section 32A(2)(i].
(viii) Unabsorbed investment allowance of earlier years [Section 32A(3)(ii)].
(ix) Current investment allowance [Section 32A(3)(i)].

Thus absorbed depreciation will have priority over unabsorbed development rebate for purpose of set-off against income in subsequent years. In case, where the unabsorbed development rebate or unabsorbed investment allowance is not set off within eight years the assessee's right to carry forward the same lapses and he would not be entitled to this deduction after that period.

(G) **Rehabilitation Allowance** '*Section 33B*) : The Section allows a deduction in cases where the business of any industrial undertaking is discontinued in any previous year on account of extensive damage to or destruction of any building, machinery, plant or furniture owned by the assessee and used by him wholly and exclusively for the purpose of the business as a direct result of any of the specified circumstances and within a period of three years from the end of that previous year the business is re-established, reconstructed or revived by the assessee. The amount of deduction by way of rehabilitation allowance shall be a sum equal to 60% of the amount of the terminal depreciation due to the assessee under Section 32(1)(ii) in respect of the building, machinery, plant or furniture which is so damaged or destroyed. The deduction will be allowed in computing the business income of the assessee in respect of the previous year in which the business is re-established, reconstructed or revived. The specified circumstances referred to above are ;

(i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of

[illegible] or (ii) riot or civil disturbance ; or (iii) accidental fire or explo[illegible] [illegible] action by an enemy or action taken in combating an enemy, [illegible] with or without a declaration of war.

[illegible] of claiming rehabilitation allowance the industrial under[illegible] engaged in the business of generation and or/distribution of [illegible] or any other form of power or in the construction of ship, or in the [illegible] goods or in mining.

[illegible] will not be available from the assessment year 1985-86 onward [illegible] amendment made by the Finance Act, 1984.

(1[illegible]) **Expenditure on Scientific Research** (*Section 35*) : This Section allows a [illegible] expenditure on scientific research related to the business [illegible] 'scientific research' as defined in Section 43(4)(i) [illegible] the extension of knowledge in the fields of natural or applied [illegible] animal husbandry or fisheries. A reference to expenditure [illegible] scientific research, would include all expenditure incurred for the [illegible] provision of facilities for the prosecution of scientific research [illegible] any expenditure incurred in the acquisition of rights [illegible] the research. In particular, a reference to scientific research related to a business or a class of business would include (*i*) any scientific research [illegible] to or facilitate an extension of that business or all the business of that class, as the case may be; (*ii*) any scientific research of a medical [illegible] relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

The deduction allowable under this Section consists of—

(*a*) any revenue expenditure laid out by the assessee himself on scientific research related to his business. Expenditure incurred within three years [illegible] preceding the commencement of the business on payment of [illegible] research personnel engaged in scientific research *related to the business* carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be available only in respect of expenditure incurred after 31st March 1973 and will be limited to the amount certified by the prescribed authority. The amount deductible as salary is subject to the limit prescribed under Section 40A(5).

(*b*) Any sum paid to a university, college or other institution or scientific research association which has, as its object, the undertaking of scientific research to be used for scientific research provided that the university, college, institution or association is approved for this purpose by the prescribed authority.

Rule 6 of the Income-tax Rules specifies the 'prescribed authority' for the purpose of Section 35, in relation to research in the field of agriculture, animal husbandry and fisheries, medical sciences, social sciences, or statistical research and other natural or applied science. The expression, prescribed authority, for

this purpose refers to the Indian Council of Agricultural Research, the Indian Council of Medical Research or the Indian Council [illegible] or the Secretary, Department of Science and Technology, [illegible] or any other officer of that Department nominated by him [illegible] appropriate to the nature of the scientific research in question [illegible] the payments so made to such institution would be allowable irrespective of the fact whether (*i*) the field of scientific research [illegible] business or not and (*ii*) the payment is of a revenue nature or of a capital nature.

(*c*) Any sum paid to an approved university, college or other institution to be used for research in any social science or statistical research related *to the class of business carried* on by the assessee.

(*d*) Any expenditure of a *capital* nature [illegible] by the assessee spread over a period of five [illegible] years [illegible] each year), if it was incurred prior to [illegible] However [illegible] expenditure had been incurred *on or after* [illegible] such expenditure would be deductible in full in the [illegible] year in which it is incurred.

However by virtue of an amendment made by the Finance Act [illegible] no deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land after 29.2.1984, whether the land is acquired [illegible] or part of any property.

For the above purpose the expression land [illegible] in land and it shall be deemed to be acquired on the date on which the document purporting to transfer the land is registered under the Registration Act [illegible] and where the possession of any land has been obtained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 on the date on which such possession was obtained.

(*e*) Where the taxpayer pays after March, 1973 any sum to an approved scientific research association or university, college or other institution for sponsored scientific research undertaken under a programme approved in this behalf by the prescribed authority, he will be allowed a *weighted deduction equal to one third times* the sum so paid. The sponsored research *need not* necessarily be related to the taxpayer's business. This is provided in sub section (2A) of Section 35.

(With effect from the assessment year 19[illegible] such weighted deduction shall be allowed only if such sum is paid with a specific direction that the sum shall not be used for the acquisition of any land building or construction of any building.

However by virtue of an amendment made by the Finance Act 1984 the weighted deduction will not be allowed in respect of such sums paid after 29-2-1984.

Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward

without any time limit in the same way as unabsorbed depreciation allowance. Thus, in a case where both unabsorbed expenditure on scientific research and carried forward business loss have to be set off, the business loss must be set off first, since it would get lapsed at the end of the eighth year.

The Explanation added to sub-section (2) specifically provides that where any capital expenditure has been incurred *prior to the commencement of the business* the aggregate of the expenditure so incurred within the three accounting years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the accounting year.

(*i*) Section 35 (2) (*iv*) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under Section 35 whether in the year in which deduction under Section 35 was allowed or in any other previous year. This provision has come into force with effect from 1st April, 1962 *i.e*, from the commencement of the Income-tax Act, 1961 with a view to superseding the effects of certain judicial rulings

(*ii*) The scope of the weighted deduction available under sub-section (2A) of Section 35 has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For this purpose, the expression "public sector company" means any corporation established by or under any Central or State or State or Provincial Act or a Government Company as defined in Section 617 of the Companies Act, 1956.

(*iii*) Sub-section (2B) of Section 35 provides that weighted deduction will be allowed in an amount equal to one fourth times the expenditure incurred by an assessee on scientific research undertaken by him, under a programme approved in this behalf by the prescribed authority, having regard to the social, economic and industrial needs of India The revenue expenditure and expenditure incurred on the purchase of machinery and equipment for carrying out the approved programmes will qualify for weighted deduction. However, it has been specifically provided that capital expenditure incurred on acquisition of land or acquisition or construction of buildings will not be allowable for this weighted deduction. The expenditure qualifying for this weighted deduction will be limited to the amount certified in this behalf by the prescribed authority. Where a deduction is allowed under this sub-section, no deduction in respect of the same expenditure will be allowed under Section 35 (i) or 35 (2) (ia) for the same or in any other previous year. Similarly, no depreciation will be allowed in respect of such expenditure either in the year in which the weighted deduction is allowed or in any other previous year.

However by virtue of an amendment made by the Finance Act, 1984 this weighted deduction will not be allowed in respect of such sums paid after 29-2-1984.

(*iv*) Section 41 has been amended to provide that where such asset is ultimately sold, whether before or after being used in the business of the assessee the sale proceeds will be included in the taxable income of the assessee. In order to ensure that this concession is not misused, it has been provided that the assessee will be required to furnish a certificate of completion from the prescribed authority after programme of scientific research has been implemented and if the assessee fails to furnish such certificate within one year of the period allowed by the prescribed authority for completion of the programme, the tax concession already allowed will be withdrawn. A suitable provision for enabling the withdrawal has been made in sub-section 5B of Section 155.

(I) **Amortisation of Capital Expenditure on Acquisition of payments and Copyrights** (*Section 35 A*): This Section provides for the amortisation of the capital expenditure incurred by an assessee acquire patents and copyrights. The provision in this regard are as under :

(*i*) Any capital expenditure incurred by an assessee after 21 2.1966 on the acquisition of patent rights or copyrights used for that purpose of the business will be allowed as a deduction in equal instalments over a period of *fourteen* years or 14 years as reduced by the number of complete years comprised in the period which has expired from the commencement of these rights and before their acquisition by the assessee, whichever is shorter. If a full period of 14 years had expired before such acquisition, then the entire cost of acquisition will be allowed in one instalment in the year of acquisition.

(*ii*) If before the end of any of the relevant previous year for which the allowance is to be made the rights come to an end without being subsequently revived or the assessee sells the rights for an amount which is not less than the capital cost of the rights remaining unallowed the assessee shall not be entitled to any deduction in respect of the rights for the previous year in which rights come to an end or are sold.

(*iii*) If the rights come to an end without being subsequently revived or are sold in their entirety and the sale proceeds are less than the cost of acquisition thereof remaining unallowed, then the cost of acquisition remaining or such cost as unallowed reduced by the sale proceeds, as the case may be, shall be allowed as a deduction (*i e.*, terminal allowance) in full in the previous year in which the rights come to an end or are sold.

(*iv*) If the rights or any part thereof are sold and the capital sum received on the sale exceeds the cost of the rights remaining unallowed then the excess will be charged to tax as profits (balancing charge) of the previous year in which the sale took place. But the amount so chargeable as profit shall be limited to the deduction already allowed to the assessee on account of these rights.

(*v*) However, if only a part of the rights is sold for an amount which is not less than the capital cost remaining unallowed the amount of the deduction to be allowed to the assessee in respect of the previous year in which the sale takes place and subsequent year will be recomputed. The recomputation will be made by reducing the capital cost remaining unallowed from the sale proceeds and the

[illegible] for the relevant year [illegible]

(vi) In a scheme of amalgamation, where patent rights or copyrights [illegible] otherwise transferred by the amalgamating company to the amalgamated [illegible] as discussed in (iii) and (iv) in respect of terminal [illegible] shall not apply to the amalgamating company, but they [illegible] apply to the amalgamated company in the same way and to the same extent as they would have applied to the amalgamating company had amalgamation not taken place. Thus in a case of amalgamation which [illegible] the meaning of the definition given in Section 2(1A) the allowance under this Section does not get forfeited on the ground that there has been a sale of the [illegible]

Example: X spent Rs 84,000 on patent rights in March, 1981. He started business in January, 1980 and closes his books in March, 1981. In September, 1981 he sold a part of his rights for Rs 52,000. How much allowance would be admissible to him for the previous year 1982-83.

Cost	*Rs.*
For the previous year *1980-81*	*84,000*
Less 1/14th of Rs *84,000*	*6,000*
For the previous year 1981-82 allowance outstanding	*78,000*
Less: Value realised	*52,000*
Amount to be allowed over 13 years	26,000
For this year 1/13th of Rs. 26,000	2,000

Export Market Development Allowance (Section 35B) : Under this Section the assessee is entitled to an export market development allowance irrespective of the consideration, whether he has exported any goods during the previous year or whether he has earned any profit out of these exports.

The provisions of this Section as amended by the Finance (No : 2) Act, 1980 (effective from the assessment year 1981-82) in regard to this allowance are as follows :

(*i*) The weighted deduction of Export Market Development Allowance provided under Section 35B shall be granted only in respect of specified expenditure incurred before 1st March 1983. Hence any expenditure incurred for the development of export market on or after 1st March 1983 would not qualify for weighted deduction. It may be noted that to the extent of amount incurred deduction would be allowed under general provisions.

(*ii*) The deduction is allowable to an assessee being domestic company or any person (other than a company) resident in India.

(*iii*) In respect of qualifying expenditure incurred after 1-4-1978 but before 1-3-1983 all domestic companies - widely-held as well as closely-held — and other resident assessees would be entitled to weighted deduction at the uniform rate of 133 1/3%.

categories of expenditure include :

(a) Advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business.

(b) Maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities.

(c) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities including travelling outward from and return to India

(d) Such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed in the Income-tax Rules.

In a notification issued recently, the CBDT has prescribed expenditure on conducting pre-investment surveys, preparation of feasibility reports or project reports at the written request of the Central Government or the foreign party, maintenance outside India of a warehouse for promotion of sale of goods outside the country, maintenance of a laboratory or other facilities for quality control or inspection of such goods and purchase of foreign trade periodicals or journals related to the business of the taxpayer.

The expenditure on maintenance of laboratory or other facilities for quality control will however, be restricted to the amount which bears the same proportion as the export sales to the total turnover of the business in respect of which such laboratory or other facilities are maintained.

Explanation 2 below clause (6) of Section 35B(1) clarifies that any expenditure which, by its very nature, is debitable to the trading account or a manufacturing account of a business, such as, wages to labourers, purchase of raw materials, carriage inward, etc., will not qualify for the weighted deduction.

It may be noted that this weighted deduction has lost much of its importance now in view of its limited application.

(K) Agricultural Development Allowance (Section 35 C) : Under this provision all *companies and co-operative societies* engaged in agro based industries in the manufacture or processing any article or thing which is made from or used in such manufacture or processing as raw materials, any product of agriculture animal husbandry or dairy or poultry farming will be eligible for a weighted deduction in computation of their business income with reference to the expenditure incurred by them in providing agricultural inputs and extension services to persons engaged in agricultural production, animal husbandry or dairy or poultry farming. The weighted deduction will be of an amount equal to one and one-fifth time the amount of qualifying expenditure. Thus if the company

or co-operative society has incurred an expenditure of Rs 50,000 the amount of deduction would be Rs. 60,000. Only companies which use the product or products of producers as aforementioned, as raw materials for their industry shall be eligible for such a deduction. Further only expenditure incurred after 29-2-1968 but before 1-3-84 in the provision of goods services or facilities, specified hereunder will qualify for the deduction :

(i) fertilizer, seeds, pesticides, concentrates for cattle and poultry feed, tools or implements for use by such cultivator, grower, producer ;

(ii) dissemination of information on and demonstration of modern techniques or methods of agriculture animal husbandry, dairy farming or advice on such techniques, or methods and

(iii) such other goods services or facilities as prescribed under Rule 6A(2) of the Income-tax Rules.

It has been clarified that such expenditure shall be allowable *only if*:

(i) It is in the form of goods, services or facilities and not cash ;

(ii) It is provided directly to cultivators, growers, or producers in India of agricultural raw materials and

(iii) It is not paid to relatives or associate concerns.

Where it has been paid to a relative or associate concern only such amount as is considered reasonable shall be allowed. The expenditure is allowable only if it has been incurred by a company or a co-operative society engaged in an agro-industry. It is allowable also when it is incurred by the company or co-operative society on its own farm It can also be incurred either directly or through an association or body which has been approved for this purpose by the prescribed authority under Rule 6A(1) of the Income-tax Rules. The expenditure in respect of which a deduction under this Section is allowed shall not again qualify for deduction under any other provisions of the Act.

The Finance Act, 1983, has amended Section 35C with a view to withdrawing the weighted element in this deduction and restricting the deduction admissible only to 00 per cent of the amount of the qualifying expenditure. The amendment will apply in relation to assessment year 1984-85 and subsequent years.

The Finance Act, 1984 has withdrawn the benefit of deduction itself with effect from 84-85 assessment year and onwards in respect of such expenditure.

Hence present legal position may be summed up as under.

1. In respect of eligible expenditure incurred after 29 2-68 but before 1-3-84 weighted deduction is available upto the assessment year 1983-84, and such deduction is limited to the actual expenditure from 84-85 assessment year onwards.

2. In respect of expenditure incurred after 28-2-84 no deduction will be allowed.

(L) Rural Development Allowance (Section 35CC) : This provision seeks to encourage *Companies and Co-operative Societies* to undertake the work of rural welfare by providing that 100% of the expenditure incurred by such companies or co operatives on or after 1st September, 1977, on rural development programmes will be treated as business expenditure if the same is incurred after obtaining approval of the prescribed authority. A committee under the chairmanship of Secretary, Department of Agriculture, Government of India is the prescribed authority for this purpose (Rule 6AA) The members of the committee are Secretaries of Department of Expenditure, Finance Ministry and Department of Industrial Development and Chairman of the C.B.D T. There is no monetary limit for the deduction of such expenditure. Even if the assessee has incurred loss, the expenditure will be treated as business expenditure and the total (including the amount spent for rural development programmes) will be allowed to be carried over to subsequent years. For the assessment year 1983 84 onwards the prescribed authority shall not approve any programme unless such programme is a programme falling within any class or category of programmes of rural development as may be specified by the Central Government in this behalf.

For the purpose of this Section, 'Programme for rual develoment' includes any programme for promoting the social and economic welfare of the public in rural area. It also includes any programme for the people in the *rural area.* The definition is inclusive and, therefore, expenditure in other areas of rural development will also be covered by this definition.

The term "rural area" would mean any area *other than* (*a*) any area which is comprised within the jurisdiction of the municipality (whether known as a Municipality, Municipal Corporation, notified area committee, town committee, or by any other name) or by a Cantonment Board and which has a population of 10,000 or less according to the last published Census ; or (*b*) any area within such distance (not being more than 15 Kilometres) from the local limits of any Municipality or Cantonment Board stated above which is notified by the Central Government for this purpose. Such notification is to be issued by the Central Government only where it is satisfied that the stage of development of the area outside any such municipal or Cantonment Board (including the extent of, and scope for, urbanisation of such area) justifies its being regarded as an urban or non-rural area.

If the expenditure in the rural area results in the acquisition or creation of an asset (building, machinery, plant or furniture) during the relevant year and the assessee continues to be the owner of the asset till the end of the year, the assessee will not be allowed a deduction in respect of such expenditure under this provision : instead depreciation under Section 32 will be allowable on such assets as if the same were used for the purpose of assessee's business and the provision of Sections 32, 34, 41, and 43 will so far as may apply accordingly The assessee, in order to claim deduction under this provision is required to furnish along with its return of income, a statement of the expenditure in the prescribed form (Form No. 2AA) duly certified by a Chartered Accountant. If any expenditure is claimed and allowed under Section 35CC in any year, deduction

for the same will not be allowed under any other Section for the same or any other year.

(M) Payments to Association and Institutions for Carrying out Rural Development Programmes (Section 35CCA) : This provision has been inserted with effect from 1st June 1978. This provision will accordingly apply in relation to the assessment year 1979-80 and subsequent years.

Under this provision, sums paid by *any tax payer*, carrying on business or profession to any association or institution which has its object the undertaking of programmes of rural development will be allowed as a deduction in computing the taxble profits where such are to be used for carrying out a programme of rural development. As a result of the amendments made by the Finance Act, 1979, with effect from 1st June, 1979 (in relation to the assessment year 1980-81 and onwards) expenditure incurred by such assessee by way of payment of any sum to an association or institution approved by the prescribed authority will also be allowed as deduction, where, such association or institution has as its objects the training of persons for implementing programmes of rural development. The deduction under this provision will not be allowed unless the association or institution, as also the programme of rural development for which such sums are paid, have been approved by the prescribed authority. The Inter Ministerial Committee, headed by the Secretary (Agriculture), which has been notified as the prescribed authority for the purpose of Section 35CC will be the prescribed authority for the purposes of this provision also. The prescribed authority will not approve an association or institution for this purpose for more than three years at a time. The expression 'programme of rural development' will have the same meaning as assigned to it under Section 35CC. The following amendments have been made by the Finance Act, 1983 in Sec. 35CCA with effect from the assessment year 1983-84.

(A) Contributions made to a Rural Development Fund set up and notified by the Central Government in this behalf shall also qualify for deduction under this Section.

(B) Any sum paid to any association or institution which has as its object the undertaking of any programme of rural development shall not qualify for deduction under this Section with effect from the assessment year 1983-84 unless all the following conditions are satisfied.

(*i*) the assessee has furnished a certificate obtained from such institution or association to the effect that the programme of rural development has been approved by the prescribed authority not later than 28th Feb., 1983. Such institution or association should have obtained authorisation in writing from the prescribed authority to issue such certificates

(*ii*) In cases such payment is made on or after 1st March 1983 and such programme involves work by way of construction of any building or other structure (whether it is for use as a dispensary, school, training or welfare centre, workshop or for any other purpose) or the laying of any road or the

construction or boring of a well or tube well or the installation of any plant and machinery, such work should have been commenced not later than 28th Feb., 1983. This should be stated in the certificate issued by such institution or association. In other words any payment made on or after 1st March, 1983 for any programme involving any of the activities referred to above shall not be allowed as deduction if such work has commenced on or after 1st March 1983.

It may be noted that any payment to any programme not involving any of the activities referred to above would qualify even if such programme's work was/is commenced after 28th Feb., 1983, however, subject to fulfilling other conditions.

(C) Any sum paid to an association or institution which has its object for training of the personnel for implementation of rural development programme, shall qualify for deduction only if all the following conditions are satisfied.

(*i*) Such institution or association has issued a certificate to the effect that it has obtained approval from the prescribed authority before 1st March, 1983 and it has obtained authorisation in writing from the prescribed authority to issue such certificates.

(*ii*) The training of persons for implementing any programme of rural development should have been commenced by the association or institution before 1st March 1983 and it has been stated to this effect in the certificate issued by it.

It is to be noted that the deduction under this provision is available to all assessees while the deduction under Section 35CC is available only to Companies and Cooperative Societies There is no monetary limit in respect of the deduction available under this provision also.

(N) **Payments to Associations and Institutions for carrying out Nature Conservation Programmes** [Sec. 35CCB] As per this provision whereby when an assessee incurs any expenditure by way of payment of any sum to an association or institution, which has as its object the undertaking of any programme of conservation of natural resources, to be used for carrying out any programme of conservation of natural resources approved by the prescribed authority the assessee shall be allowed a deduction of the whole of such amount in computing the taxable profits of such expenditure incurred during the previous year It is important to note that the payment to the association or institution to be eligible for deduction must be approved for the time being by the prescribed authority, shall not grant such approval for more than three years at a time. The above provision is to be made effective from 1-6-1982.

Amortisation of Preliminary Expenses (Section 35D) : Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and business concerns to be formed, or for expansion of the business of existing

concerns. This Section applies *(a)* only in respect of expenses incurred after 31-3-1973 : *(b)* only to Indian Companies and resident persons but not to non-residents and foreign companies ; *(c)* in the case of new companies—to expenses incurred before the commencement of the business ; *(d)* in the case of extension of an existing industrial undertaking – to expenses incurred till the extension is complete ; *(e)* in the case of a new industrial unit—to expenses incurred till the new unit commences production or operation. The assessee is entitled to a deduction of an amount equal to one-tenth of the qualifying amount of the expenditure for each of the ten successive accounting years beginning with the year in which the business commences or, as the case may be, the previous year in which the extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

The kinds of expenditure that are amortisable are the following :

1. Expenditure in connection with : *a)* the preparation of feasibility report : *(b)* the preparation of project report ; *(c)* conducting marketing survey or any other survey necessary for the business of the assessee ; *(d)* engineering services relating to the assessee's business ; *(e)* legal charges for drafting any agreement, between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee.

2. Where the assessee is a company, in addition to the above, expenditure incurred *(f)* by way of legal charges for drafting the Memorandum and Articles of Association : *(g)* by way of fees for registering the company under the Companies Act ; *(h)* in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus ; and

3. *(i)* Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provisions of the Act) as may be prescribed by the Board for the purpose of amortisation.

In the case of expenditure specified in items *(a)* to *(d)* of 1 above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or of any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

Overall limits : The maximum amount of the aggregate of the qualifying expenses that can be amortised has been fixed at 2½% of the cost of the project or in the case of an **Indian** company at the option of the company, 2½% of the capital employed in the business of the company. The excess, if any, of the qualifying expenses shall be ignored.

The process of amortisation is the deduction of one-tenth of such expenditure for a period of ten years beginning from the year of commencement of business or completion of extension of the undertaking or commencement of production or operation of the new unit, as the case may be.

For purposes of amortisation, the expression *'cost of the project'* means :

(*i*) In the case of expenses incurred before the commencement of business the actual cost of the fixed assets, being land, building, leasehold, plant, machinery, furniture, fitting, and railway siding (including exdenditure on the development of land or building), which are shown in the books of the assessee as on the last day of the previous year, in which the business of the assessee commence.

(*ii*) In the case of extension of the business or setting up of a new unit the cost of the fixed assets, being land, building, leasehold, plant, machinery, furniture fitting and railway sidings (including expenditure on the development of land or building) which are shown in the books of the assessee on the last day of the previous year in which the extension of the industrial undertaking is completed, or as the case may be, the new industrial unit commences production or operation in so far as such fixed assets have been acquired or developed in connection with the extension of the industrial undertaking or the setting up of the new industrial unit.

(*iii*) in case of a new company, the aggregate of the *issued share capital debentures, and long-term borrowing as on the last day of the previous year in which the business of the company commences* :

(*iv*) in the case of an extension of the business or the setting up of a new unit, the aggregate of the issued share capital, debentures, and long-term borrowings on the last day of the accounting year in which the extension of the industrial undertaking is completed or, as the case may be, the new industrial unit commences production or operation, in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the industrial undertaking or the setting up of the new industrial unit of the company.

The expression "long term borrowing" as used above, means any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any banking institution or any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of capifal, plant and machinery, where the terms under which moneys are borrowed or the debt is incurred, provided the repayment thereof during a period of not less than seven years.

In cases where the assessee is a person other than a company or a co-operative society the deduction would be allowable *only if* the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by an accountant *and* the assessee furnishes, along with his return of income for the first year in respect of which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditors setting forth such other particulars as may be prescribed.

Where the undertaking of an Indian company is transferred before the expiry of the period of ten years to another Indian company in a scheme of amalgamation as defined in Section 2(1A) the aforesaid provisions will, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

It has been clarified that in case, where a deduction under this Section is claimed and allowed for an assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any of the other provisions of the Act for the same or any other assessment year

(P Amortisation of Expenses for Prospecting and Development of Mines (*Section 35E*) ; This new provision for amortisation of expenses for *the prospecting and development of mines* was introduced by the Taxation Laws (Amendment) Act, 1970 with effect from 1 4.1971. The provision applies only to expenditure incurred by an Indian company or any other person who is resident in India. Thus foreign companies or foreign concerns and non resident assessees are not entitled for the benefit of deduction under Section 35E In order to qualify for amortisation the assessee should be engaged in *any operation relating to prospecting for or the extraction or production* of any mineral and expenditure qualifying for amortisation should have been incurred at any time after 31st March, 1970.

The nature and kinds of expenditure qualifying for amortisation are : (*i*) It must have been incurred by the assessee after 31 3.1970 *ii*) It must be incurred during the year of commercial production or any or more of the four years immediately preceding that year. (*iii*) It must be expenditure incurred wholly and exclusively on any operations relating to the prospecting for or extraction of any of the 27 minerals or 16 groups of associated minerals or on the development of a mine or other natural deposit of any mineral or group of associated minerals specified in the Seventh Schedule to the Income-tax Act.

However, any portion of the expenditure which is met directly or indirectly by any other person or authority and any sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of expenditure should be excluded from the amount of expenditure qualifying for amortisation Further specific provision has been made to the effect that the following items of expenses do *not* qualify for amortisation at all, *viz*.

(*i*) Expenditure incurred on the acquisition of the *site of and source of* minerals or group of associated minerals stated above or of any right in or over such site ; or

(*ii*) expenditure on the acquisition of *the deposits of such mineral* or groups of associated mineral referred to above or of any rights in or over such deposits : or

(*iii*) expenditure of a capital nature *in respect of any building, machinery, plant or furniture* for which depreciation allowance is permissible under Section 32 of the Act.

The assessee will be allowed for each one of the ten relevent previous years a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure. Thus the deduction to be allowed for any relevant accounting year is (*i*) one-tenth of the expenditure ; (*ii*) such amount as will reduce to *nil* the income of that accounting year arising from commercial exploitation of any mineral or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amount of the deduction admissible in respect of any relevant accounting year, to the extent to which it remains unallowed shall be carried forward and added to the instalment relating to the accounting year next following and shall be deemed to be a part of the instalments and so on, for ten accounting years, beginning from the year of commercial production.

For purposes of this amortisation *operation relating to prospecting*, means any operation undertaken for the purpose of exploring, locating or proving deposits of any mineral and includes any such operations which prove to be infructuous or abortive. The expression '*year of commercial production*' means the previous year in which as a result of any operation relating to prospecting, commercial production of any mineral or one or more of the minerals in a group of associated minerals specified in part A or part B, respectively of the Seventh Schedule to the Act. The relevent previous years in which the deduction would be allowed to the assessee are those ten accounting years beginning with the year of commercial production.

Where a deduction is claimed and allowed on account of amortisation of the expense under Section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction from the profits and gains under any other provision of the Act for the same or any assessment year. The provision in regard to audit of accounts relating to the qualifying expenditure and the continuance of the allowance in cases of amalgamation are similar to those applicable for amortisation of preliminary expenses discussed earlier :

(Q) **Other Deductions (Section 36)** : This Section authorises dedu.tion of specific expenses. The items of and the conditions under which such expenditure are deductible are discussed below.

Insurance premia paid [Clause (i)] : If the insurance policy has been taken out against risk of damage or destruction of the stock or other assets of the business or profession the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under this clause.

Under clause (ia) in sub-section (1) of Section 36 the amount of premium paid by a federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a primary milk co-operative society affiliated to it, will be allowed as a deduction in the computation of profits of the federal milk co-operative society.

Bonus and Commission [Clause (ii)]: *These are allowable subject to the conditions:*

(*a*) *The sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission. It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits*

(*b*) *In respect of bonus paid to an employee employed in a factory or other establishment to which the provisions of the Payment of Bonus Act, 1965, apply, the amount of deduction shall not exceed the amount of bonus payable under the Act.*

(*c*) In respect of employees other than those who are covered by the Payment of Bonus Act, 1965 the amount of bonus or commission must be reasonable having due regard to : (*i*) the pay of the employees and conditions of his service ; (*ii*) the profits of the business of the year ; and (*iii*) the general practice in similar business.

Weighted Deduction to Employers, employing blind or handicapped persons: Clause (*iia*) in sub-section (1) of Section 36 provides for a weighted deduction of an amount equal to one and one-third times the salary paid to such persons. The weighted deduction will be admissible only in respect of employees whose income chargeable under the head 'Salaries' does not exceed Rs. 20 000/- during the relevant previous year. For the purpose of this concession, salary will include the allowance, bonus or commission whether payable monthly or otherwise. In order to qualify for this concession, the employer will have to produce to the Income tax Officer in respect of the first assessment year for which deduction is claimed under this provision, the certificate as to the total blindess of the employee from a registered oculist and in the case of an employee who is suffering from a permanent physical disability a certificate from a registered medical practitioner to the effect that the employee suffers from a permanent physical disability, which has the effect of a substantially reducing his capacity to engage in gainful employment. This amendment will take effect from 1st April, 1981 and will accordingly apply in relation to the assessment year 1981-82 and onwards.

As a result of the amendment made by the Finance Act, 1984, the benefit of weighted deduction will not be available in respect of salary paid for any period of employment after 29-2-1984.

Interest on Borrowed Money [Clause (iii)] : In the case of genuine business borrowings the Department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under Section 40 or 40A. The interest paid on capital borrowed for expanding a business is allowable under this clause although the assets brought into existence with the help of the borrowed capital had not been actually used for the business. But the amount allowable is limited only to interest ; It does not include any bonus or premium paid on redemption of debentures. For the purpose of allowing the interest on borrowing it is immaterial, whether the borrowed

moneys are utilised for capital or revenue purposes and the assets acquired by the borrowings are brought into use during the accounting year or not.

For the purposes of this provision, recurring subscriptions paid periodically by shareholders or subscribers in Mutual Benefit Societies which fulfil such conditions, as may be prescribed, shall be deemed to be capital borrowed. This is made clear in the Explanation to Section 36(1) iii).

Contributions to Provident and other Funds [Clauses (iv) and (v)]: *Contributions to the Employees' Provident Fund and other Funds are allowable subject to the following conditions :*

(*a*) *The Fund should be settled upon a trust.*

(*b*) *In the case of a Provident or a Superannuation or a Gratuity Fund it should be the one recognised or approved under the Fourth Schedule to the Income-tax Act. Even if the fund is not recognised, contributions thereto will be allowed provided that the employer has made prescribed arrangement for making deduction of tax at source from any payments made from the fund.*

(*c*) The amount contributed should be a periodic payment and not an *ad hoc* payment to start the fund.

(*d*) The fund should be for the exclusive benefit of *the employees.*

The nature of the benefit available to the employees from the fund is not material ; it may be pension, gratuity or provident fund.

Allowance for animals Clause (vi) ; This clause grants an allowance in respect of animals which have died or have become permanently useless. The amount of the allowance is the difference between the actual cost of the animal and the price realised on the sale of the animal itself or its carcass. Thus the allowance under this clause would recoup to the assessee the entire capital expenditure in respect of animals-

Bad debts [Clause (vii) and sub-section (2)] : These can be deducted subject to the following conditions :

(*a*) The debt or loan should be in respect of a *business which was carried on* during the relevant accounting year.

(*b*) The debt should have been taken into account in computing the income of the assessee of the relevant accounting year or an earlier accounting year or should represent money lent by the assessee by the ordinary course of his business of banking or money lending.

(*c*) The amount of the debt or loan, or part thereof, which is claimed as deduction should be established to have become bad during the accounting year.

(*d*) The amount should be written off as irrecoverable in the account of the assessee for that accounting year in which the claim for a deduction is *made for the first time.*

Further, if on the final settlement the amount recovered in respect of any debt, where a deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be

claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is thus permissible for the Income-tax Officer to allow a deduction in respect of bad debt or any part thereof, in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Furthermore, where any debt has been written off as irrecoverable in the account of previous year and the Income-tax Officer is satisfied that such a debt or part thereof in fact had become a bad debt in any earlier previous year not falling beyond a period of four previous years, immediately preceding the previous year in which it is written off, the Income-tax Officer may rectify the assessment of the relevant previous year in which the debt should have been allowed provided the assessee accepts such a finding [Section 155 (5)].

Recovery of a Bad Debt Subsequently [*Section 41* (*4*)] : If a deduction has been allowed in respect of bad debt or part of the debt under Section, 36, and subsequently the amount recovered in respect of such debt or part thereof is more than the amount due after the allowance had been made the excess shall be deemed to be the profits and gains of profession, and accordingly will be charged to income tax as the income of the previous year in which the amount is ultimately recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at that time.

For example, let us assume that a debt of Rs. 10,000 was claimed as a bad debt in the year 1976. However, the I.T.O. allowed only a sum of Rs. 5000 as a bad debt. If in the year 1978, a sum of Rs. 4,000 is recovered ultimately in respect of the debt, then the I T.O. would allow a deduction in respect of the deficiency namely, Rs. 1,000 [*i e.* the difference between the amount ultimately recovered and the amount disallowed earlier], under Section 36(1)(*vii*) If on the other hand, the sum ultimately recovered is Rs 6,000 then there will be a liability, under Section 41(4) in respect of sum of Rs. 1,000 (being the excess of the amount actually recovered over the amount disallowed earlier) Such a liability under Section 41(4) could arise even if the business or profession in respect of which deduction has been allowed is not in existence at that time.

Bad Debts Reserve by Commercial Banks [clause viia]. This clause provides that any provision for bad and doubtful debts made by a scheduled commercial bank, in relation to advance made by its rural branches, in an amount not exceeding 1½% of the aggregate average advances made by such branches will be allowed as deduction in the computation of its taxable profits. The aggregate average advances to be made will be computed in the manner to be prescribed in the rules. For the purposes of this clause a 'rural branch' will mean a branch situated in a place with a population not exceeding ten thousand.

The benefit of this deduction has been extended by the amendment made by the Finance Act, 1982 to non scheduled banks also, with effect from 1st April, 1983.

Special Deduction to Financial Corporation providing Long-term Finance for Industrial development [clause (viii)] : Under Section 36(1)(viii) of the Income-tax Act a special tax concession is granted to Financial corporations providing

long-term finance for the development in industry and agriculture. This provision is an exception to the general rule that no deduction is admissible in computing taxable profits in respect of any appropriation of income which the tax payer may make out of his profits. It is only under this specific provision, financial corporations are permitted to appropriate their profits towards reserves with a view to augmenting their resources.

Under this provision the deduction allowable to the corporation is calculated at a specified percentage of its total income (not necessarily the business income) as computed before making any deduction admissible to the corporation under Sections 80A to 80VV of the Income-Tax Act. In the case of a Financial Corporation or a joint Financial Corporation established under the State Financial Corporations Act 1951 or an Institution which is deemed under Section 46 of that Act to be a financial corporation established by any state government for that state within the meaning of that Act, the amount of deduction admissible shall be 40 per cent of the total income of the corporation for the relevant assessment year which is carried to a special reserve account. In the case of any other financial corporation the amount admissible as deduction is 25 per cent of the total income of the financial corporation as computed in the manner mentioned above.

It is, however, essential that in both the cases the amount admissible as deduction should be carried to the reserve account of the financial corporation. In cases where the aggregate of the amounts carried to the reserve account of the corporation from time to time exceeds the paid-up share capital (excluding the amounts capitalised from reserves) of the corporation, no further allowance would be admissible to the corporation in respect of any profits appropriated to the reserve in excess of the paid-up share capital. Likewise, the deduction is admissible only so long as and, that too, to the extent to which the profits appropriated to the reserve account are equal to or less than the paid-up share capital of the corporation The allowance of this deduction is also subject to the further condition that the financial corporation is for the time being approved by the Central government for purposes of this benefit.

With a view to enabling all approved financial corporations to build up resources at an accelerated speed the Finance Act, 1979 has amended Section 36(1) (viii) with effect from 1st April 1980 to secure that in the case of all financial corporations (other than State Financial Corporations) the amount of deduction admissible under Section 36 (1) (viii) in respect of the profits appropriated to its special reserve shall be allowed at 40% of such profits (as against 25 per cent upto 31st March, 1980). In the case of State Financial Corporations the limit for appropriation continues to remain at 25%.

Special Reserve Created by a Scheduled Bank [Clause viii a]: The above concession is extended by the Finance Act 1982 to Scheduled Bank (other than a bank incorporated by or under the laws of a country outside India) which is

engaged in banking operations outside India, a deduction in respect of an amount not exceeding forty percent of the total income (computed before making any deduction under chapter VIA) carried by it to such reserve account. It may be noted that the bank concerned must be approved by the Central Government for the time being for enjoying the concession stated in the said clause. This amendment is effective from the assessment year 1983-84.

Expenses on Family Planning [Clause (ix)] : Any expenditure of a *revenue* nature *bona fide* incurred by a *company* for the purposes of promoting family planning amongst its employees will be allowed as a deduction in computing the company's income from business. Where the expenditure incurred in this respect is of a *capital* nature, one fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. The deduction is allowable only to companies and not to other assessees. The assessee would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation without any time limit. The expenditure on promoting family planning will be treated in the same way as capital expenditure or scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including transfer on amalgamation.

It may be noted that under Section 80G, all assessees would be entitled to deduction In respect of donations to the Government or any such local authority, institution or association, approved in this behalf by the Central Government to be utilised for the purpose of promoting family planning subject to the limits specified therein.

(R) **General expenses (Section 37)** : *Revenue expenditure incurred for purposes of carrying on the business profession or vacation* : This is a residuary Section under which only business expenditure is allowable but not the business losses, *e g* , those arising out of embezzlement, theft, destruction of asset, misappropriation by employees *etc*. These are available under Section 29, as losses incidental to the business The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

Conditions of Allowance : The following conditions should be satisfied in order that a particular item of expenditure may be deductible under this Section :

(*a*) The expenditure should not be of the nature described in Sections 30 to 36 and Section 80VV. It may be noted that the Taxation Laws (Amendment) Act, 1975 has introduced Section 80VV, with effect from 1-4-1979. This new Section provides for deduction from the gross total income in respect of expenses incurred in connection with certain proceedings under the Income-tax Act up to a maximum of Rs. 5,000.

(*b*) It should have been incurred by the assessee in the accounting year.

(*c*) It should be in respect of a business carried on by the assessee the profits of which are to be computed and assessed.

(*d*) It must have been incurred after the business was set up.

(*e*) It should not be in the nature of any personal expenses of the assessee.

(*f*) It should have been laid out or expended *wholly and exclusively* for the purpose of such business.

(*g*) It should not be in the nature of a capital expenditure The principles to be followed for distinguishing capital expenditure from revenue are discussed below :

The Section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It may be observed that the Section requires that the expenditure should be wholly and exclusively laid down for purposes of the business but not that it should have been necessarily laid out for such purposes. Therefore, expenses wholly and exclusively laid out for purposes of trade are subject to the fulfilment of other conditions allowed under this Section even though the outlay is unnecessarily large in case of companies where Section 40 (*c*) is applicable,

(1) *'Character as a Trader'*—The expenditure should be incurred by the assessee in his character as a trader.

(2) *'Voluntarily Expenditured on Grounds of Commercial Expediency'*—A sum of money expended, not out of necessity and with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on the business may yet be expended wholly and exclusively for purpose of the trade.

(3) *"Direct Concern and Direct Purpose"*—In order to ascertain, whether the expenditure has been incurred wholly and exclusively for the purposes of the business one must look to the direct concern and direct purposes for which the money is laid out and not to the remote or indirect results which may possibly motive or flow from the expenditure.

(4) *'Purpose of the Assessee's Business'*—The expenditure should be primarily incurred for the assessee's own business. Notwithstanding this proposition so long as the whole and the exclusive purpose of the expenditure is the purpose of the assessee's trade and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure accrues to a third party's benefit or that expenditure incidentally obtains some advantages in some character other than that of a trader would not defeat the effect of the finding that the expenditure was wholly and exclusively incurred for purposes of the assessee's business.

(5) *'Unremunerative Expenditrve'*-The expenditure need not be incurred solely for the purpose of earning profit in the year of account. For example, cost of repairs or advertisement, or on a foreign tour by the Managing Director might be deductible even though the income therefrom would be earned in future years.

(6) *Treatment in Assessee's Account*—The manner in which an item of

expenditure is treated in the assessee's account is not a conclusive evidence against or in favour of the assessee.

Payment out of Profits and Payment ascertained by Reference to Profit — When a trader makes a payment which is computed in relation to profits, the question that arises is: Does the payment represent a mere division of profits with another person or is it an item of expenditure the amount of which is ascertained by reference to profits? The payment would be allowable in the second case but not in the first

Distinction Between Capital and Revenue Expenditure: The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of expenditure is always a mixed question of law and fact. In deciding, whether an expenditure is of a revenue or of a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the objects for which the expenditure had been incurred. Whether a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose, one must look to not only the documents but also the surrounding circumstances to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and the conclusion must be arrived at on the question whether on a fair appreciation of the whole situation as evident from the facts the expenditure in question incurred in a particular case is of a revenue nature or a capital nature. One of the tests that may be applied is, if the expenditure is for the initial outlay or for acquiring or bringing into existence an asset or advantage of an enduring benefit to the business that is being carried on, or for the extension of the business that is going on, or for a substantial replacement of our existing business asset, it would be a capital expenditure whereas if, on the other hand, the expenditure although for the purpose of acquiring an asset or advantage, is for running of the business or for working out that asset with a view to produce profit it would be a revenue expenditure.

The capital or revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The facts that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of account or other documents would not always be indicative or conclusive, as to what the real nature of transaction is.

Miscellaneous instances of Revenue Expenditure: Payment made for use of quota rights or the cost of raw material used for manufacturing purposes is revenue expenditure. In the case of a hotel or restaurant business the cost of table, linen, crockery pots and pans is a revenue expenditure. The cost of dredging carried on by a harbour authority for the purpose of keeping the channels

clear for shipping is also a revenue expenditure. Expenditure incurred by a surgeon or businessmen on a study tour abroad to acquire knowledge of the latest techniques would be revenue account.

Miscellaneous Instances of Capital Expenditure : Expenditure on improvement to a property as distinguished from mere repairs, expenditure that is incurred by a company in issuing debentures for capital, would be capital expenditure. Legal expenses incurred in connection with the mortgage of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

For a detailed study of the case law on the question of the allowability of expenses in different circumstances and the tests to distinguish between capital and revenue disbursements students are advised to refer to the discussion under Section 37 in the Students edition of Kanga and Palkhiwala's Income-tax Students should also go through the illustrations given in Sukumar Bhattacharya's book.

(S) **Entertainment Expenditure [Section 37 (2A)]** : With effect from 1-4-1977—assessment year 1977-78 and onwards—the allowance in respect of entertainment expenditure incurred by an assessee, whether incurred within or outside India, is regulated as per sub-section (2A) of the Section 37. The deduction would be allowed in respect of the actual entertainment expenditure or an amount calculated at the following rates with reference to profits and gains from business or profession *whichever is less* :

(*a*) on the first Rs. 10 lacs of the business profit—1/2% subject to a minimum of Rs. 5,000;

(*b*) on the next Rs. 40 lacs—1/4%

(*c*) on the next Rs. 120 lacs—1/8%

(*d*) on the profit exceeding Rs. 120 lacs—Nil.

For the assessment year 1984—85 and for subsequent assessment years, the following rates would be applicable.

(*a*)	On the first Rs. 10 lacs of the business profits	½% subject to a minimum of Rs. 5,000
(*b*)	On the next Rs. 10 lacs	¼%
(*c*)	On the balance of the profits and gains of business or profession	1/8%

But the maximum allowance permissible is Rs. 50,000.

It should be noted that the above percentage limits should be calculated with reference to the quantum of profits and gains of the business or profession as computed *before* allowing the deduction not only in respect of development rebate, development allowance and entertainment expenditure but also in respect of investment allowance admissible under Section 32A.

For the purposes of the provision, the expression 'entertainment expenditure' includes : (*i*) entertainment allowance paid to employees, (*ii*) expenditure in the nature of entertainment expenditure incurred for the purpose of business or profession of the assessee by any employee or other person.

As per the new Explanation added by the Finance Act, 1983 with effect from the assessment year 1984-85 'entertainment expenditure' for the ceiling limits notified above, includes expenditure on provision of hospitality of every kind by the assessee to any person whether by way of food or beverages or in any other manner whatsoever and regardless of the fact that whether such provision is made by reason of any express or implied contract or custom or usage of trade. However, entertainment expenditure for this purpose does not include any expenditure on food or beverages provided by the assessee to his employees irrespective of their place of work.

(T) Expenditure on Advertisement in Souvenirs etc., published by Political Parties [Section 37 (2B)] : The Taxation Laws (Amendment) Act, 1978 has inserted a new sub-section (2B) in Section 37 with effect from 1st April, 1978. The new provision provides that notwithstanding anything contained in sub-section (1) of Section 37, no deduction shall be allowed in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party. Since the term 'political party' has not been defined for the purposes of this provision, it will bear its ordinary and therefore wider connotation for the purpose of this provision.

(U) Expenditure on the Maintenance of Guest Houses [Section 37 (3)] : Any expenditure incurred by an assessee on the maintenance of guest houses other than holiday homes *after* 28-3-1970 shall be altogether disallowed in computing the income from business or profession. The disallowance will be not only of the establishment and other expenses for running the guest house but also the depreciation on the building, where it is owned by the assessee and rent paid for the accommodation, where it has been taken on hire or lease. Depreciation on assets such as air-conditioners, cooking ranges, furniture and fittings, *etc.* in the guest house will also be disallowed. Where any charges are recovered from persons using the guest house these will be deducted from the expenditure on the maintenance and depreciation and only the balance will be disallowed. For this purpose, the accommodation hired or reserved by the assessee in a hotel for a period exceeding six months will be treated as a guest house and the expenses incurred on its maintenance will be disallowed accordingly. However, in the case of an assessee having in his employment not less than 100 whole-time employees throughout the relevant previous year the expenditure incurred on the maintenance of any "holiday home" exclusively for the use of his employees while on leave will not be disallowed.

(V) Expenditure on Advertisement, Publicity etc.

Section 37 (3) read with Rule 6B of the Income-tax Rules, 1962 places the following restrictions on the allowance of expenditure on advertisement :—

(*a*) A ceiling limit of Rs 50 is placed on the value of each article intended for presentation.

(*b*) In respect of expenditure in foreign exchange for publicity outside India the deduction is limited to the amount for which foreign exchange permission is granted

(*c*) Any single payment exceeding Rs. 2,500 in respect of expenditure on advertisement is not allowed as a deduction unless it is made by a crossed cheque/crossed bank draft.

(*d*) The Income tax Officer is empowered to disallow expenditure which, in his opinion is excessive or unreasonable having regard to the legitimate business needs of the assessee and the benefit derived by him and accruing to him therefrom. The disallowance can be made by the I. T. O. only if the payment is made :—

(*i*) to a person who has a substantial interest in the business of the assessee or a relative of such a person or

(*ii*) to a person who carries on business or profession as a publicity or as an advertising agent and the assessee has a substantial interest in that business or profession. 'Substantial interest' in this context means a right to not less than 20% of the profit or beneficial ownership of not less than 20% of the equity capital.

The Finance Act 1983 has inserted clauses (3A,) (3B,) (3C) and 3D with effect from the assessment year 1984-85.

As per clause (3A,) where the aggregate expenditure incurred by an assessee on any one or more items specified in clause 3B (discussed in next para) exceeds Rs. 1,00,000, twenty per cent of such excess shall not be allowed as a deduction from business income under Sec. 37(1).

The various items of expenditure which comes within the scope of disallowance, as specified in clause (3B) are as follows:

(*a*) advertisement, publicity and sales promotion ;
(*b*) running and maintenance of aircraft and motor cars:
(c) payments made to hotels.

According to the Explanation given, for this purpose, the expenditure specified above shall be the aggregate amount of expenditure incurred by the assessee as reduced by any amount of such expenditure which is not allowed under any other provision. The explanation specifies that expenditure on advertisement, publicity and sales promotion shall not include remuneration paid to employees of the assessee engaged in any of the said activities. It also clarifies that the expenditure on running and maintenance of aircraft and motor cars shall include (i) expenditure incurred on chartering any craft (ii) expenditure on hire charges for engaging cars plied for hire, (iii) conveyance allowance paid to employees and in case of companies it also includes conveyance allowance paid to directors.

It may be noted that as provided in clause (3C), no disallowance would be made in the hands of any corporate assessee being a domestic company and in the case of any non-corporate assessee being resident person in India, in respect of expenditure wholly and exclusively incurred on the following activities:

(*a*) On advertisement, publicity and sales promotion outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business.

(*b*) On running and maintenance of motor cars in any branch, office or agency maintained outside India for the promotion of the sale of such goods, services or facilities.

No expenditure incurred on running and maintenance of an aircraft would be disallowed in the case of an assessee engaged in the business of operation of aircraft No disallowance would be made in respect of expenditure incurred in running and maintenance of motor car in the case of an assessee engaged in the business of running motor cars on hire. [*Clause 3D*].

(W) **Expenditure in connection with Travelling etc**: Under Rule 6D of the I.T. Rules the amount of expenses allowable in respect of travelling outside India by an employee of the assessee or any other person shall be limited to aggregate amount of foreign exchange granted or permitted to the assessee for such a travel and the amount expended on such travel in terms of rupees. The amount allowable should be ascertained by dividing the actual number of days mainly devoted by the person outside India by the total number of days spent by him outside India, excluding in both cases the days taken for such travel by a reasonable direct route.

So far as travel within India outside the headquarters is concerned the expenditure allowable is limited to the aggregate of the following amounts:

(*a*) in respect of travel by rail, road, waterways or air, the expenditure actually incurred;

(*b*) in respect of any other expenditure including hotel expenses or allowance paid in connection with such travel;

(*i*) in the case of an employee salary is Rs 1,000 *p.m.* or more.	Rs, 150 per day or part thereof
(*ii*) in the case of any other employee	Rs. 75 per day or part thereof.
(*iii*) in the case of any person.	An amount calculated on the basis of the amount applicable to the highest paid employee.

If the stay of the employee or other person outside his headquarters is in Bombay, Calcutta or Delhi the amount computed at the above rates can be increased by 33⅓% of such amount. However, if the employee or other person stays outside the headquarters, free of charge, in a guest house maintained by the

assessee the amount in that case shall be calculated at 1/3rd of the aforesaid rates and, where the employee or other person is provided free lodging. at 50% of the aforesaid rates.

(X) **Limits of Reserves for Unexpired Risk** : Under Rule 6E of the Income-tax Rules in computing the income from any business of insurance other than life insurance, the deduction in respect of the amount carried over to a reserve for unexpired risks including the amount of any additional reserve shall be restricted to : (*a*) in the case of a fire or miscellaneous insurance business—50% of the net premium income of the previous year, (*b*) in case of a marine insurance business 100% of the premium income of the previous year.

However, the amount of reserve of additional reserve disallowed under this provision in any year shall not be included in the total income in the next year for purpose of assessment. 'Net premium income' means the amount of premium received as reduced by the amount of reinsurance premium paid in respect of the relevant previous year.

SELF-EXAMINATION QUESTIONS

These questions are intended to enable the student to test his knowledge before proceeding to answer the test paper. The answers to those questions are not required to be written out and submitted for evaluation. In the following questions, one of the statements put in under alphabetical order is correct. State which is correct. For example, the answer to Q No. 1 is (b).

1. The term 'business' has been defined in Section. (*a*) 2(36). (*b*) 2(13). (*c*) 2(18). (*d*) 17. (*e*) 2(47). ( )
2. The term 'profession' has been defined to include (*a*) business. (*b*) agency. (*c*) employment. (*d*) vocation. ( )
3. Income from business or profession should be computed in accordance with Sections (*a*) 45 to 55. (*b*) 28 to 44. (*c*) 56 to 59 (*d*) 22 to 27. ( )
4. Compensation received for termination of managing or other agency or for the modification of any of the terms and conditions relating thereto, is taxable as income from (*a*) property, (*b*) capital gains, (*c*) other source, (*d*) business. ( )
5. Trade, professional or other similar association are chargeable to tax under the head 'profits and gains of business, or profession', on their income derived from (*a*) specific services rendered to their members, (*b*) transfer of capital assets, (*c*) membership and entrance fees of their members, (*d*) all sources. ( )
6. The value of any benefit or perquisite arising from business or the exercise of any profession is taxable as income from (*a*) salaries, (*b*) other sources, (*c*) business or profession, (*d*) capital gains. ( )
7. Speculation business of an assessee must be deemed to be (*a*) a part and parcel of the entire business as a whole, (*b*) an ancillary business, (*c*) a separate and distinct business. ( )

8. Losses incidental to the trade are allowable as a deduction under Section (a) 28, (b) 29, (c) 37, (d) 36.

9. The list of allowances permissible under Sections 30 to 44A of the Act is (a) exhaustive, (b) not adequate, (c) not exhaustive, (d) self-contained. ( )

10. If a businessman having business connection with a non-resident is assessed as the statutory agent of the non-resident's income and is unable to recover the amount of tax from the non-resident, the tax so paid by him is (a) allowable as bad debt, (b) allowable as loss incidental to the trade (c) allowable as expenditure incurred wholly and exclusively for the business, (d) not allowable as a deduction. ( )

11. Rent for the business premises is available as a deduction if the building is (a) let out, (b) owned, (c) taken on rent (d) taken on lease by the assessee. ( )

12. Where a part of the business premises is sub-let, the allowance for rent, shall be (a) allowable in full (b) allowable in part (c) a proportionate sum (d) the difference between the rent paid by him and the rent recoverred from the subtenant. ( )

13. Assets in respect of which depreciation is allowable under the Income-tax Act are : (a) goodwill (b) buildings, machinery, plant or furniture (c) investment (d patents and copyright. ( )

14. An assessee is entitled to depreciation for the full year (a) even if the asset is used for the business at any time during the accounting period (b) for each asset proportionate to the period of its use during the year (c) only if the asset is used throughout the year (d) only if the asset is used for not less than six months during the year. ( )

15. In order to claim depreciation allowance as deduction from business income the assessee must (a) hire (b) lease (c) own (d) let out the depreciable assets : ( )

16. Depreciation on (i) ocean-going ships and (ii) building, machinery, plant or furniture is allowed on the basis of (a) written-down value (b) actual cost (c) machine hour rate (d) replacement price.

17. If the assessee's accounting period consists of 18 months for any particular assessment year and the amount of normal depreciation for a period of 12 months is Rs 36,000 the normal depreciation allowable for the relevant assessment year is (a) Rs. 40,000 (b) Rs. 80,000 (c) Rs. 54,000 (d) Rs. 24,000.

18. Assets acquired for Rs. 5,000 or less in the previous year ended 31st March 1984 are allowed as a deduction in full in the same year if they are (a) buildings (b) machinery or plant (c) furniture and fittings (d) patent and copyrights. ( )

19. Initial depreciation allowance is permissible in respect of : *(a)* furniture, *(b)* machinery or plant, *(c)* buildings *(d)* business premises. ( )

20. In order to qualify for initial depreciation allowance the building must be used for the welfare purposes of employees, whose salary income is *(a)* Rs. 10,000 p.a. or less, *(b)* Rs. 18,000 p.a. or more, *(c)* Rs. 12,000 p a. *(d)* Rs, 30,000 p.a. or more.

21. The rate of depreciation in respect of buildings which are used for the welfare of low paid employees is *(a)* 40% *(b)* 30% *(c)* 25% *(d)* 40% of the actual cost of building. ( )

22 In order to qualify for initial depreciation the hotel building must be owned by *(a)* an Indian resident assessee, *(b)* an Indian company, *(c)* non-resident Indian citizen, *(d)* foreign companies. ( )

23. Extra depreciation in respect of machinery or plant is allowable to *(a)* all assessees, *(b)* all Indian citizens, *(c)* all resident assessees who are citizens of India, *(d)* all Indian companies running hotels which are approved by the Central Government for granting higher development rebate ( )

24. The amount of extra depreciation available to hotel is *(a)*, 25% *(b)* 50%, *(c)* 30%, *(d)* 60% of the normal depreciation for the relevant year. ( )

25 For purposes of allowing extra shift allowance the total number of working days in any year shall be the actual number of days on which the factory has worked or *(a)* 270; *(b)* 30, *(c)* 180, *(d)* 240 days whichever is higher. ( )

26. Extra shift allowance is allowable in the case of *(a)* all factories, *(b)* seasonal factories, *(c)* hotels, *(d)* factories which work in shifts. ( )

27. Terminal depreciation is allowable in respect of building, machinery, plant, or furniture in respect of the accounting year in which the asset is *(a)* sold, destroyed, discarded or demolished, *(b)* gifted, *(c)* transferred by a parent company to its subsidiary *(d)* surrendered to the Government in the course of compulsory acquisition.

28. If the asset is sold or otherwise transferred in the same year in which it was first put to use the assessee would be entitled to *(a)* terminal depreciation, *(b)* normal depreciation, *(c)* no depreciation, *(d)* extra depreciation. ( )

29. Depreciation on the capital expenditure incurred in building over which the assessee has a right to occupancy is allowable with effect from *(a)* 1-4-70 *(b)* 1-4-1971 *(c)* 1-4-1969 *(d)* 1-3-1970 *(e)* 1-9-1971. ( )

30. Depreciation on imported motor cars will be available only if they are (*a*) used in business of running it on hire for tourists (*b*) owned by Ministers (*c*) owned by officers of the income-tax Department. ( )

31. If an asset whose cost of acquisition, W.D.V. and sale price are Rs. 50 000, R. 30,000 and Rs. 20.000 respectively there will be (*a*) terminal depreciation of Rs. 10,000 (*b*) balancing charge of Rs. 10,000 (*c*) normal depreciation of Rs. 20,000 (*d*) initial depreciation of Rs. 10,000 in the year of sale. ( )

32. Unabsorbed depreciation can be carried forward (*a*) for 8 years (*b*) for 4 years (*c*) indefinitely without any time limit (*d*) for ten years.

33. Unabsorbed depreciation brought forward from earlier years can be set off in the subsequent year against (*a*) income from business or profession (*b*) income under any head (*c*) income from property (*d*) capital gains (e) current depreciation. ( )

34. Recomputation of the depreciation allowable in any year may be made by (*a*) reopening the assessment under Sec. 147 (*b*) making a best judgment assessment under Sec. 145 (*c*) making a provisional assessment (*d*) making a regular assessment (*e*) treating it as a rectification of mistake under Section 154. ( )

35. A part or whole of the depreciation allowable on any asset or any business may be disallowed under Section (*a*) 32 (*b*) 40 (*a*) (*v*) (*c*) or 40 A (5) (*d*) 38 (*e*) 40 A (2) and (3). ( )

36 Investment allowance is allowable in respect of assets which are in the nature of (*a*) building (*b*) machinery or plant (*c*) furniture (*d*) ship or aircraft (*e*) goodwill. ( )

37. Investment allowance is allowable in the year in which the asset is (*a*) acquired or installed and put to use in the immediately succeeding year of its acquisition or installation, then in that year (*c*) first put to use (*d*) ordered for (*e*) sold or otherwise transferred. ( )

38. If a company following the calendar year as the accounting year acquires a ship for Rs. 40,00,000 on 30th December, 1978 and the ship is first put to use by the company only on 10th January 1980 the investment allowance allowable to the company is—(*a*) Rs. 16,00,000 in the accounting year 1978 (*b*) Rs 16,00,000 in the accounting year 1977 (*c*) Rs. 12 00,000 for the assessment year 1978 79 (*d*) nil. ( )

39. Ships, machinery or plant will qualify for the allowance of investment only if they are (*a*) imported from abroad (*b*) new and are put to use by the assessee for the first time in their life or second-hand satisfying

certain specified conditions (*c*) borrowed from a foreign businessman (*d*) acquired from or with the prior approval of the Central Government ( )

40. In order to qualify for investment allowance the assets must be kept by the assessee in the capacity of (*a*) mortgagee (*b*) hirer (*c*) pledger (*d*) owner (*e*) lessee.

41. Second-hand machinery or plant will qualify for investment allowance only if they are acquired at any time after (*a*) 31-3-1976, (*b*) 1-4-1970, (*c*) 31-5-1954, (*d*) 31-3-1974, (*e*) 1-4-1972. ( )

42. In order to claim investment allowance the assessee must create (*a*) secret reserve (*b*) general reserve (*c*) investment allowance reserve (*d*) capital reserve.

43. The investment allowance reserve should be not less than of the amount of investment allowance actually allowed in respect of (*i*) ships (*ii*) machinery or plant. (*a*) 75% (*b*) 50% (*c*) 80% (*d*) 60% (*e*) 30%. ( )

44. The investment allowance reserve is to be created by debiting an equal amount to the (*a*) P & L App. A/c., (*b*) Sinking Fund A/c (*c*) P&L A/c, (*d*) Balance Sheet (*e*) General Reserve A/c. ( )

45. The asset acquired should not be sold or otherwise transferred except in specified circumstances for a period of (*a*) 10 years, (*b*) 8 years, (*c*) 6 years, (*d*) 4 years from the end of the relevant accounting year in which the asset was acquired or installed. ( )

46. The rate of investment allowance in the case of (*i*) ships, (*ii*) machinery or plant would be (*a*) 25% and in certain special cases of plant and machinery 35% (*b*) 15% (*c*) 30% (*d*) 40% of the actual cost of the asset. ( )

47. Unabsorbed investment allowance can be carried forward for a maximum period of (*a*) 10 years, (*b*) 6 years (*c*) 8 years, (*d*) 4 years, from the end of accounting year in which the assessee was entitled to the allowance. ( )

48. Development allowance is granted in respect of the actual cost of (*a*) acquiring plant or machinery, (*b*) planting or replanting tea bushes, (*c*) planting coffee and rubber plantations, (*d*) planting medical drugs. ( )

49. The rate of development allowance is (*i*) for new plantation, (*ii*) for replantations, [*a*] 20% [*b*] 60% [*c*] 50% [*d*] 75% of the actual cost of planting or replanting.

50. Rehabilitation allowances is available with effect from [*a*] 1-4-1970, [*b*] 1-4 1967, (*c*) 1-4-1972, (*d*) 1-4-1974. ( )

51. *The amount of rehabilitation allowance is calculated at (a) 60% of the terminal depreciation allowable. (b) 50% of the normal depreciation, (c) 75% of the profits of the year (d) 40% of the development rebate.* ( )

52. Capital expenditure incurred by an assessee on scientific research will be deductible (*a*) over a period of 5 years one fifth being allowable in each year (*b*) 50% in the relevant year 50% in the next year, (c) in full in the same year (*d*) as depreciation allowance by way amortisation ( )

53. Unabsorbed capital exdenditure on scientific research relating to any year can be carried forward (*a*) indefinitely without any time limit, (*b*) for 8 years, (*c*) 5 years, (*d*) for 10 years.

54. For purposes of amortisation the life of a patent or copyright is taken to be (*a*) 8 years, (*b*) 10 years, (*c*) 5 years, (*d*) 14 years. ( )

55. If an individual assessee spends Rs. 60 000 before 1st March, 1983 for developing export markets abroad he will be entitled to a deduction (*a*) Rs. 60,00' (*b*) Rs. 80,000 (*c*) Rs. 30,000, (*d*) Rs. 40,000. ( )

56. A company will be entitled to deduction on account of export markets development allowance only if the company is (*a*) a trading company (*b*) an investment company, (*c*) an industrial company, (*d*) a domestic company, (*e*) a public company. ( )

57. Agricultural development allowance is granted to (*a*) all companies and cooperative societies (*b*) Indian companies, (*c*) domestic companies, (*d*) agricultural trading companies, (*e*) Industrial companies. ( )

58. If an assessee spends Rs 30,000 in the previous year ended 31st March 1982 for providing goods or services to agriculturists the amount of deduction will be (*a*) Rs. 30,000, (*b*) Rs. 40,000, (*c*) Rs. 36,000, (*d*) Rs 45,000, (*e*) Rs. 20,000. ( )

59. The amount of preliminary expenses qualifying for amortisation should be restricted to (*a*) 2½% (*b*) 10%. (*c*) 8%, (*d*) 6%, (*e*) 5%, of the capital employed or the cost of the project. ( )

60. The qualifying amount of preliminary expenses for prospecting and development of mines should be allowed as a deduction over a period of 10 years at the rate of (*a*) 1/8th, (*b*) 1/6th., (*c*) 1/10th, (*d*) 1/5th of the qualifying amount.

61. In order to qualify for getting allowance for amortisation of preliminary expense or expenses for prospecting and development of mines of assessee (not being a company or a co-operative society) should get its accounts of the relevant year in which the expenditure was incurred duly audited

by (*a*) the Registrar of Companies, (*b*) I.T O., (*c*) Coutroller & Auditor General, (*d*) A Chartered Accountant. ( )

62. If an assessee pays bonus to his employees in 1980 for the year 1977 on the basis of an award of the Industrial Tribunal the amount of bonus is to be allowed as a deduction (*a*) for the year 1975 by reopening the assessment made earlier. (*b*) for the year 1980, (*c*) for the financial year 1977-78, (*d*) for the assessment year 1975-76.

63. An assessee following the calendar year as the accounting year incurred a loss of Rs. 80,000 on account of bad debts for the year 1978 of which Rs. 40,000 alone was allowed by I.T.O. In 1978 the assessee recovered Rs. 50,000 out of bad debt written off earlier in 1978. He will be taxable on (*a*) Rs. 5,000, (*b*) Rs. 10,000 (*c*) Rs. 80,000, (*d*) Rs. 56,000 (*e*) Rs. 25,000.

64. Expenditure on family planning among the employees will qualify for deduction while computing business income if the assessee is (*a*) a company, (*b*) individual, (*c*) H.U.F., (*d*) firm. ( )

65. Revenue expenditure which is not of a personal nature incurred wholly and exclusively for the purpose of the business is to be allowed as a deduction under Section (*a*) 22, (*b*) 36, (*c*) 40, (*d*) 41, (*e*) 37, (*f*) 28 single of the Act. ( )

INADMISSIBLE EXPENSES/PAYMENTS

Amounts not deductible (Section 40) : By dividing the assessee into four distinct groups this Section places absolute restraint on the deductibility of certain expenses as follows :

(*a*) *In the case of any assessee*

(*i*) Any interest payable outside India (not being interest on a loan issued for public subscription before the 1st day of April, 1938) on which tax has not been paid or deducted at source and in respect of which there is no person in India who may be treated as an agent under Section 163.

(*ii*) Any sum paid on account of tax or cess levied on profits on the basis of or in proportion to the profits or gains of any business or profession.

(*iii*) Any sum paid on account of Wealth-tax.

(*iv*) Any sum which is chargeable under the head "Salaries" if it is payable outside India and tax has not been paid or deducted at source therefrom under Chapter XVII B of the Act.

(*v*) Any contribution to provident fund or other fund established for the benefit of employees of the assessees, unless the assessee has made effective arrangement to secure that tax shall be deducted at source from any payment made from the fund which are chargeable to tax under the head 'Salaries'.

(b) In the case of any firm—

Any payment by way of interest, salary, bonus, commission or remuneration (but not rent) made by the firm or any partner of the firm.

(c) In the case of any company –

(*i*) *Any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director or to any other person who has a substantial interest in the company or to a relative of the director or such person.*

(*ii*) Any expenditure or allowance in respect of any asset of the company used by any person referred to in the foregoing sub paragraph either wholly or partly for his own purposes or benefit.

The aforesaid payment would be disallowed if the income-tax officer considers that any such expenditure or allowance is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom. The deduction on account of such expenditure or allowance will be further subject to an overall ceiling limit of Rs. 72,000 (Rs. 1,02,000 w. e. f 1985-86 assessment year) in respect of any one director or person who has a substantial interest in the company or a relative of a director or of such person.

Therefore, where the expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the maximum amount allowable shall not exceed Rs. 72,000 (Rs. 1,02,000 w. e. f 1985 86 assessment year). But in cases where such expenditure or allowance relates to a period not exceeding eleven months comprises in the previous year. The maximum amount of allowance should be calculated at the rate of Rs. 6,000 (Rs. 8,500 w. e. f. 1985-86 assessment year) for each month or part thereof comprised in that period. However, in cases where the director or person having substantial interest in the company or a relative of either of them, is also an employee of the company for any period comprised in the previous year, the following items of expenditure shall not be taken into account for the purposes of disallowance under Section 40 (*c*).

(*i*) the value of any travel concession or assistance and the value of any free or concessional passage qualifying for total exemption under Sections 10 (5) and (6) (*i*) ;

(*ii*) any contribution by the employees to any recognised provident fund or to an approved superannuation fund or to an approved gratuity fund as is referred to in Section 36(1) (*iv*) and (*v*) ;

(*iii*) any expenditure incurred by the company for the purpose of promoting family planning specified in Section 36(1) (*ix*).

It may, however, be noted that the amount of ceiling specified in Section 40 (*c*) only indicates the maximum amount allowable ; the amount of actual allowance may be even less than the limits prescribed.

(b) *In the case of a banking company* amounts which have been allowed as a deduction in computing its income chargeable to income-tax under the head 'interest on securities' under Section 20 (1).

Expense or Payment not deductible in certain circumstances : Section 40 (A) : (*a*) *Payments to relatives or associates :* Section 40A (2) provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or any associate, concern, so much of the expenditure as is considered to be excessive or reasonable shall be disallowed by the I. T O in computing the business income of the assessee. While considering whether a certain payment is excessive or reasonable, the I. T. O. shall have due regard to : –

(*i*) the market value of the goods, services or facilities for which the payment is made ; or

(*ii*) the legitimate needs of the business or profession carried on by the assessee ; or

(*iii*) the benefit derived by or accruing to the assessee from such a payment.

The word "relative" as defined in Section 2 (41) of the Act means in relation to an individual, the husband, wife, brother or sister or any lineal ascendant or descendant of that individual. Where the assessee is a firm, H. U F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and members of the family or association. Similarly, where the assessee is a company the relationship will be reckoned with reference to directors of or persons having substantial interest in the company. The expression 'associate concern' means a concern, which has a substantial interest in the business of the assessee or in which the assessee or any of his relatives has a substantial interest.

(*b*) *Cash payment in excess of Rs. 2,500 :* According to Section 40A (3) all payments in excess of Rs. 2,500 claimed as deduction while computing business income if made otherwise than by a crossed cheque or draft drawn on a bank will be disallowed. If, in case where such payments made otherwise than by crossed cheque or draft are allowed through oversight or otherwise I. T. O. may disallow the same subsequently by reopening the past assessments by treating it as a rectification of mistake under Section 154(1). The operation of the provision can be relaxed at places where it could not be complied with due to the absence of banking facilities or under such circumstances, as may be prescribed.

This provision applies to all categories of expenditure involving payments for goods or services which is deductible in computing the taxable income It does not apply to loan transactions because advancing loans or repayment of the principal amount of the loan does not constitute on expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs. 2.500 at a time are required to be made by crossed cheques or draft as interest is a deductible expenditure. This requirement does not apply to payments

made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payments made by the commission agent to the party concerned against supply of goods. However, where a commission agent purchases goods on his own account but not on commission basis, this requirement will apply. The provisions regarding payments for goods by crossed cheque or draft apply equally to payments made for goods purchased on credit provided that the payment is made of an amount exceeding Rs. 2,500 at a time.

Rule 6DD of the Income-tax Rules permits, with effect from 1-4-1969, certain categories of payments under certain circumstances otherwise than by a crossed cheque or draft. Accordingly, the provisions of Section 40A (3) do not apply to certain cases. These include payments made to Bank, Central or State Government payments made through Banks, payments of terminal benefits such as gratuity, retrenchment compensation *etc*, to low paid employees and payments in areas with no banking facilities. The exceptional cases include the following also :

(*a*) payments which are made to the Reserve Bank of India, or State Bank of India or other banking institutions including co-operative banks and land mortgage banks, primary credit societies. Life Insurance Corporation of India, Unit Trust of India and certain specified institutions providing industrial finance ;

(*b*) payments which, under contracts entered into before 1-4-1969, have to be made only in cash;

(*c*) payments made to the Central or State Government which, under the rules framed by the Government, are required to be made in legal tender;

(*d*) payments made in village and town having no banking facilities to person ordinarily residing or carrying on business or profession in such villages or towns.

(*e*) *Disallowances of Managerial Remuneration [Section 40A (5) and (6)] :* Any expenditure incurred by an assessee on payments of *salary to an employee* will not be allowed as a deduction in computing the taxable profit to the extent it exceeds an amount calculated on the rate of Rs 5,000 Rs. (7,500 from 85-86 assessment year onwards) for each month or part thereof comprised in the period of employment of the employee in India. This limit will also be applicable to the salary to research personnel engaged in scientific research which is deductible under section 35 (1) (*i*). Similarly, expenditure incurred by the assessee on payment of *salary to a former employee, i e.*, an individual who ceases or ceased to be the employee of the assessee during the previous year or any earlier previous year will not be allowed as a deduction in computing the taxable profits to the extent it exceeds Rs. 60,000 (Rs 90,000 from year 85-86 assessment year onwards) for the year,

For this purpose the expression 'salary' has been defined broadly on the lines of the provision in Section 17 of the Act subject to certain modifications. The expression 'salary' will include wages, any annuity or pension, any gratuity, any fees or commission, profits in lieu of or in addition to any salary or wages, any advance of salary and the annual accretion to the balance to the credit of an employee participating in a recognised provident fund to the extent it is chargeable to tax. It will not, however, include perquisites and the sums transferred from the account of the employee in an unrecognised provident fund to a recognised provident fund. In this context, the expression 'profit' in lieu of salary will have the same meaning as in Section 17 *(3)* of the Act and will, therefore, include any compensation paid by the tax-payer to an employee or a former employee in connection with the termination of his employment or modification of the terms and conditions relating thereto.

Section 40A (5) further imposes certain restrictions on the deductible amount of expenditure which is incurred for providing any *perquisites*, where convertible into money or not, to an employee or the amount of expenditure or allowance (such as depreciation allowance) in respect of assets used by an employee for his own purposes or benefit. The aggregate of the expenditure or allowance in the regard that can be allowed as a deduction in computing the taxable profits will be limited to 20% of the amount of salary payble or an amount calculated at the rate of Rs. 1,000 for each month or part thereof comprised in the period of employment of the employee in India during the relevant accounting period *whichever is less.*

For this purpose, the expression, *perquisite* has been defined to mean :— (*i*) the value of any rent-free accommodation provided to the employee by the assessee ; (*ii*) the value of any concession in the matter of rent respecting any accommodation provided to employee by the assessee ; (*iii*) the value of any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessee ; (*iv*) any sum paid by the assessee in respect of any obligation, which but for such paymant, would have been payable by the employee ; and (*v*) any sum paid by the assessee, whether,—directly or through a fund, other than a recognised provident fund or an approved superannuation fund to, effect an assurance on the life of an employee or to effect a contract for an annuity.

In case of company assessee, where a director or a person having substantial interest or a relative of the director or such person, happens to be an employee, the aggregate of the expenditure and allowance coming under the scope of this provision [Section 40A (5)] as the expenditure and allowance referred to in Section 40 (*c*) will qualify for deduction subject to a maximum limit of rupees seventy-two thousand (Rs. 1,02,000 from 85 86 assessment year onwards).

However, it has been specifically provided that the following items will *not* be taken into account in computing the expenditure or allowance that would not be deductible under this provision.

(*i*) the value of any leave travel concession or assistance granted by the taxpayer to his employee who is an Indian citizen and his or her spouse and children in connection with his proceeding to any place in India,

whether, on leave or after retirement from service, to the extent the amount thereof does not exceed the value of the travel concession or assistance which would have been received by the employee if he had proceeded to his home district in India.

(*ii*) passage moneys or the value of any free or concessional passage granted by the tax-payer to any employee who is not a citizen of India and his or her spouse and children in connection with his proceeding to his home country out of India, whether on leave or on retirement from service. [These items of benefits are already exempt from tax under Section 10(5) and 10(6)(*i*) of the Act]

(*iii*) the employer's contribution to the employee's account in any recognised provident fund or an approved superannuation fund or for the employee's benefit to an approved gratuity fund ; and

(*iv*) where, the tax-payer is a company, any expenditure incurred by it for the purpose of promoting family planning amongst its employee.

The ceiling over deductible amount of expenditure in respect of salary and perquisites *etc* , will *not*, however, be applicable in the following three cases; *viz*.

(*i*) payment to an employee in respect of any period of his employment outside India ;

(*ii*) payments to a foreign technician who is entitled to exemption from tax and his remuneration under Section 10 (6) (*vii*) or (*viia*) of the Act ; and

(*iii*) payments to an employee whose income chargeable under the head "salaries" does not exceed Rs. 7,500 per annum.

Where the assessee has incurred any expenditure on payment of fees for services rendered by a person who, at any time, during the 24 months immediately preceding the relevant year was an employee of the assessee, Section 40A (6) provides that such expenditure by way of fees or where the assessee has also paid any salary to such person during the relevant year, the aggregate expenditure on the payment of such fees and salary shall not exceed Rs. 60,000.

By virtue of an amendment by the Finance Act 1984 the above monetary limit has been raised to Rs. 90,000 with effect from assessment year 1985-86.

Further, sub-section (1) of Section 40A specifically provides that the provisions for allowance of expenses or payments in all the above cases shall apply notwithstanding anything to the contrary contained in any other provision of the Act relating to the computation of income from business or profession. Thus even if these items of expenses or payments are deductible under any other Section, the I.T.O. is entitled to disallow the same under this Section,

(*d*) *Disallowance of Reserves created or Provisions made for Payment of Gratuity* [*Section 40A* (*7*)]. The Finance Act, 1975 has introduced this provision. Under this provision no deduction will be allowed in the computation of profits and gains of a business or profession, in respect of any reserve created or provision made for the payment of gratuity to the employees on retirement or on termination of employment for any reason. This restriction will, however, not apply in relation to any provision made for the purpose of payment of a sum by way of contribution towards an approved gratuity fund that has become payable during the previous year, or for the purpose of meeting actual liability in respect of gratuity to the employess that has arisen during the previous year.

(*e*) *Disallowance of Interest paid by non-banking non-financial Companies on public Deposits* [Section 40A (8)] : Under this provision, with effect from 1st April, 1976 fifteen per cent of the interest paid by non-banking, non-financial companies on deposits received by them from the public will be disallowed in computing their total income.

For purposes of this disallowance the expression "banking company" must be taken to mean a company to which the provisions of the Banking Regulation Act, 1949 apply to include any banking institution referred to in Section 51 of that Act.

The term "deposit" means any deposit of money with, and includes any money borrowed by a company. But the term "deposit" would not, however, include any amount received by the company :

(*i*) From the Central Government or any State Government or any local authority or from any other source where the repayment of amount is guaranteed by the Central Government or a State Government ;

(*ii*) From the Government of a foreign State or from any citizen, from a foreign State or from any institution, association or body (whether incorporated or not) established outside India.

(*iii*) As a loan from a banking company or from a co-operative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or cooperative land development bank)

(*iv*) As a loan from any institution or a body specified in the list in the Tenth Schedule to the Income-tax Act or such other institution or body as the Central Government may, having due regard to the nature and objects of the institutions or body, by notification in the Official Gazette, specify in this behalf.

(*v*) From any other company.

(*vi*) From an employee of the company by way of security deposit.

(*vii*) By way of security or as an advance from any purchasing agent, selling agent or other agent in the course of or for the purpose of the business of the company or as advance against orders for the supply of goods or for running

of the services in the ordinary course of the business or profession carried on by the assessee.

(*viii*) *By way of subscription to any share, stock, bond or debenture where, bond or debenture being secured by a charge or a lien on the assets of the company pending the allotment of such share, stock, bond or debenture or by way of advance payments of any moneys uncalled and unpaid upon any shares in the company if such moneys are not repayable in accordance with the articles of association of any company.*

(*ix*) As a loan from any person where the loan is secured by creation of a mortgage, charge, or pledge of any of the assets of the company (such loan being known as the relevant loan) and the amount of relevant loan together with the amount of any other prior debt or loan secured by the creation of mortgage, charge or pledge of such assets is not more than 75% of price that such assets would ordinarily fetch on sales in the open market on the date of the mortgage, charge or pledge for the relevant loan.

The expression "*financial company*" has been defined in the Explanation to mean :

(*i*) A hire-purchase finance company, that is to say, a company which carries on as its principal business, hire purchase transaction or the financing of such transactions.

(*ii*) An investment company, that is, a company which carries on its principal business the acquisition of shares, stock, bonds, debentures, debenture stock or other securities issued by the Central Government, a State Government or a local authority or other marketable securities of a similar nature.

(*iii*) A house-financing company, that is a company which carries on as its principal business, the business of financing of the acquisition or construction of houses including the acquisition or development of the land in connection therewith.

(*iv*) A loan company, that is, a company which carries on its principal business, the business of providing finance, whether by making loans or advances or otherwise. (However companies referred to in any of the first three cases mentioned above, would not fall within the scope of meaning of the expression "loan campany.")

(*v*) A mutual benefit finance company, that is, a company which carries on as its principal business the business of acceptance of deposits from its members and which is declared by the Central Government under the provisions of Section 620A of the Companies Act, 1956 to be a *Nidhi* or mutual benefit society. And

(*vi*) A miscellaneous finance company, that is, a company which carries on exclusively or almost exclusively two or more classes of business referred to in any of the preceding five cases.

Contributions by employers to funds, trusts etc : The Finance Act. 1984 has inserted three new sub-sections 9, 10 and 11 to Section 40A. These sub-sections have been introduced to curb the growing practice among employers to claim deductions from taxable profis of the business of contributions made apparently to the welfare of employees' from which however no genuine benefit flows to the employees.

Accordingly no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any *fund, trust, company, association of persons, body of the individuals, society* registered *under the Societies Registration Act 1860 or other institution* for any purpose. However, where such sum is paid in respect of Provident fund or gratuity fund governed by the provisions of section 36(1)(iv) and 36(1)(v) or by any other law, then the deduction will not be denied.

Now there may be cases where the trustees of such funds. trusts etc., might have laid out some expenditure bona fide wholly and exclusively for the welfare of the employees of the assessees. In order to ensure that the retrospective introduction of this provision does not result in hardships in genuine cases, sub-section 10 allows deduction of such expenditure provided :

(*i*) It is not of capital nature

(*ii*) it has been incurred before 1.3.1984

(*iii*) no deduction of such expenditure has been allowed under any other provisions of the I.T. Act.

Assuming that the assessee has made some contributions to such funds, trusts etc., the question arises whether in view of the specific disallowance by sub-section (9) of Section 40A he would be able to get back those sums from such trusts etc. According to sub section (11) this is possible provided the assessee has paid such sums before 1.3.1984. He has to make a claim for the repayment of the amount remaining unspent or the retransfer of any asset being land, building, machinery, plant or furniture acquired by such fund, trust etc. Then either the unspent amount has to be returned or the asset has to be retransferred to the assessee.

A new section 43B has been inserted by the Finance Act 1983 with effect from the assessment year 1984-85. As per this section, deduction would be allowed in the previous year in which payment is made in the following cases.

(*i*) Any sum payable by the assessee by way of tax or duty under any law. In this category sums payable as excise duty, sales tax, import duty etc. would fall.

(*ii*) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of the employees.

As a result of this provision, any sum payable falling in either of the two categories referred to above shall not be allowed in the previous year in which the liability to pay such sum was incurred by the assessee if such sum was not paid during that year. This provision applies irrespective of the fact whether the assessee is following mercantile system of accounting or cash system of accounting or any other system of accounting.

Where a deduction is allowed in respect of the sums referred to above for the assessment year 1983-84 or for any earlier assessment year based on the fact that the liability to pay such sum was incurred by the assessee in the previous year relevant to such assessment year, no deduction would be allowed in respect of such sum when they are actually paid.

6. **Profits Chargeable to Tax (Section 41)** : This Section enumerates certain receipts which are deemed to be income under the head "Profits and gains of business or profession." Such receipts would attract charge even if the business from which they arose had ceased to exist prior to the year in which the liability under this Section arose. The particulars of such receipts are given below :

(1) *Remission of Liability of Recoupment of losses, expenditure* : If any allowance is granted, in any year, in respect of any loss, expenditure or trading liability and subsequently, the assessee receives, whether in cash or any other manner whatsoever, an amount in respect of cash loss or expenditure, or the assessee is granted a remission or an abatement in the trading liability the amount received or that remitted or abated would be chargeable as business profits of the year in which the amount is received or remission or an abatement is granted. This liability could arise even if the business or profession in respect of which allowance or deduction has been made, is not in existence in that year.

(2) *Balancing Charge* : If the assessee is able to recover more than the written down value, out of the moneys payable in respect of an asset on adding thereto the amount of scrap value, if any, the excess amount recovered, upto the extent of total depreciation allowance granted in the past, would be subject to tax. It is balancing charge that ensures that the assessee would not receive by way of depreciation and sale proceeds of scrap an amount in excess of the actual cost of the asset. Such addition thus shall never exceed the amount of depreciation allowed to the assessee. The sub-section would apply even though the moneys are received after the business has ceased to exist in the year in which the moneys payable become due. In case the value of the asset has been fixed under Section 33 on a basis other than the actual cost of the assessee the amount to be added as income under this sub-section shall be proportionate.

(3) *Balancing Charge in respect of assets used for Scientific Research* : It is a provision analogous to the provision in respect of depreciation assets, applicable to assets purchased for scientific research. The provisions in this regard have been discussed earlier under the topic 'Expenditure on scientific research.'

(4) *Final Adjustment in the Year of Recovery of bad debts* : The provision in this regard have alreacy been discussed under Section 36 (1) (*vii*) under the head "bad debts".

(5) *Carried over Loss of defunct Business :* In case where a receipt is deemed to be profit of a business under this Section relating to a business that had ceased to exist and there is an unabsorbed loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this Section. This sub-section thus constitutes an exception to the rule that if a business has ceased to exist, any loss relating to it cannot be carried forward and sef off against any income from another source.

Miscellaneous Provisions

A. Special Provision for Deduction in case of Business for Prospecting etc. for Mineral Oil (Section 42) : This Section has been enacted to permit an assessee to claim an allowance which may on general principles be inadmissible e g., allowances relating to diminution or exhaustion of wasting capital asset or allowances in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial expenditure incurred on the setting up of a profit earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract arrangements entered into by the Central Government for prospecting or for the extraction or production of mineral oils.

The allowance permissible under this Section shall be in relation (*i*) to expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee ; (*ii*) after the beginning of commercial production, the exdenditure incurred by the assessee, whether before or after commercial production, in respect of drilling or exploration activities or services in respect of physical assets used in that connection [except those assets which qualify for depreciation allowance under Section 32] : and (*iii*) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding year or years as may be specified in the agreement, The items of these allowances should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation in the business of the Central Government for the prospecting for an exploration of mineral oil. It has been specifically provided that the other provisions of the Act are being deemed for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of agreement. It may be noted that the allowances in this regard shall be made in lieu of or in addition to other allowances permissible under the Act, depending upon the terms of the agreement.

B. Changes in the rate of Exchange of Currency (Section 43A) : The introduction of this Section was prompted by the devaluation of the rupee in June, 1966. Consequent upon changes in the official value of the currency, the

values of certain liabilities, in respect of assets brought from outside India, prior to devaluation against foreign loans on deferred payment arrangement payable in foreign currency also change. This Section permits change in the book value or written down value of such assets. Thus, the change in the liability would result in an increase or decrease in the actual cost of the asset and consequently the amounts of depreciation allowance in respect of capital expenditure on scientific research, amortisation of cost of patents or copyrights acquired from abroad, allowance in respect of capital assets acquired by a company for purposes of family planning amongst its employees and also for the purpose of ascertaining the capital gains.

In case the assessee is not to bear the change in the rate of exchange of the currency, because of the benefit of someone else providing funds to him or as a result of future transaction regarding foreign exchange, no change would be deemed to have taken place in the cost of the asset. Section 43A(2) specifically provides that the increase or decrease in liability caused by a change in the foreign exchange rates shall not in any way affect the allowance of development rebate.

C. *Insurance business* (*Section 45*) : This Section exempts an insurance business of any kind from the operation of the Section dealing with specific heads of income as well as those of Section 199 which deals with credit for tax deducted at source, to the extent to which provisions of this Section are inconsistent with the Rules, contained in the First Schedule to the Act, and provides that profits and gains of such a business, from all sources, are to be computed notionally in accordance with these rules. This principle is applicable even to mutual associations and co-operative societies carrying on insurance business.

D. *Special Provisions in the case of Certain Associations* (*Section 44A*) : This is a provision calculated to encourage the development activities carried on by trade professional and other associations other than those whose incomes are already exempted under Section 10(23A). This Section provides that where the expenditure incurred by an association solely for purpose of protection or advancement of the common interests of its members, exceeds the amount collected by the association from its members whether by way of subscription or otherwise the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head "Profits and gains of business or profession", if there is no such income, then it will be allowed as deduction in computing the income under any other head But only an amount up to 50% of the total taxable income of the association can be set off against the deficiency aforementioned In computing the taxable income of the association effect must first be given to the allowance or losses brought forward under any other Section of the Act This Section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

Audit of accounts of certain persons carrying on business or profession: (Section 44AB) : This section has been introduced by the Finance Act, 1984 with effect from 85-86 assessment year. Accordingly it is obligatory for a person carrying on business to get his accounts audited before "the specified date" by an accountant, if the total sales, turnover or gross receipts in business for the previous year exceeds Rs. 40 lakhs. A person carrying on profession will also have to get his accounts audited before the said date if his gross receipts in profession for the previous year exceeds Rs 10 lakhs. Such persons have also to obtain before the specified date a report of the audit in the prescribed form.

In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also obtains before the said date the report of audit in the prescribed form in addition to the report of audit required under such other law. Thus, for example, the proposed provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act The new provision only requires that companies should get their accounts audited under the Companies Act before the specified date and in addition to the report required to be given by the auditor under the Companies Act obtain from him a report for tax purposes in the form to be prescribed in this behalf by the Central Board of Direct Taxes.

The expression 'accountant' shall have the same meaning as in the Explanation below sub-section (2) of Section 288.

The expression "specified date" in relation to the accounts of the previous year or years relevant to any assessment year means the date of the expiry of four months from the end of that year or where there is more than one previous year, from the end of the previous year which expired last before the commencement of that assessment year or the 30th June of such assessment year, whichever date falls later.

E. Special Provisions applicable to Non-resident Assessees

(i) Profits and Gains of Business in the case of non-residents (Section 44B) : With effect from 1st April, 1967, in the case of a non resident, the profits and gains from the business of operation of ships will be taken at an amount equal to 7½ per cent of the amount paid or payable to the assessee or to any other person on his behalf, on account of the carriage passengers, livestock, mail or goods shipped at any Indian port as also of the amount received, or deemed to be received in India on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

(ii) Deduction of Head-office Expenditure in the case of Non-residents (Section 44C) : This Section seeks to provide for a ceiling in respect of deduction to be allowed on account of expenditure in the nature of head-office expenditure in computing the profits and gains of a *non-resident*.

Foreign companies operating through branches in India sometimes try to reduce the incidence of tax in India by inflating their claims in respect of head-office expenses. It is extremely difficult sometimes to verify such claims, particularly in the absence of account books of the head-office which are kept outside India. With a view to getting over these difficulties, Section 44C lays down certain ceiling limits for the deduction of head-office expenses in computing the taxable profits in the case of non resident taxpayers. Under this provision, the deduction in respect of head-office expenditure will, broadly, be limited to :

(*i*) an amount equal to 5 per cent of the adjusted total income of the tax-payer for the relevant year ; or

(*ii*) the annual average of the head office expenditure allowed during a base period of three previous years, *i.e.*, the previous years relevant to the assessment years 1974-75 to 1976 77 ; or

(*iii*) the actual amount of head-office expenditure attributable to the business in India whichever is the *least*.

In cases where the adjusted total income of the non-resident for the relevant year is a loss, the rate of 5 per cent referred to in (*i*) above will be applied with reference to the average adjusted total income of the non-resident for three previous years immediately preceding the relevant assessment year. The term "head-office expenditure" as defined for the purposes of this provision means executive and general administration expenditure in respect of :

(*a*) rents rates, taxes, repairs or insurance of premises, outside India :

(*b*) salary, bonus, commission, *etc*, paid to any employee or other person employed in, or managing the affairs of, any office outside India;

(*c*) travelling by any such employee or other person outside India ; and

(*d*) *such other* matters connected with executive and general administration as may be presented by the board

The expression 'adjusted total income', 'average adjusted total income' and 'average head-office expenditure' have been defined in the Explanation to Section 44C.

(*iii*) *Computation of Income by way of Royalties, etc, in the case of Foreign Companies [Section 44D]* : Section 44D provides that in the case of foreign company the deduction that would be admissible in computing its income by way of royalties. or fees for technical services received from an Indian concern in pursuance of an agreement made by it with the Indian concern *before First April, 1976* will be limited to 20 per cent of the gross amount of such income (including lumpsum payments received outside India for the delivery of designs and drawings relating to any patent, invention, *etc.*, outside India). *No* such deduction will be admissible in case where any royalties or fees for technical services are received by a foreign company from an Indian concern in pursuance of an agreement made by it with the Indian concern *after 31st March, 1976*.

SELF-EXAMINATION QUESTIONS—II

1. State whether the following statements are true or false:

   (*a*) Payments on accounts of wealth-tax will be allowed as deduction to the extent they can be attributed to business assets.

   (*b*) A reasonable amount of salary paid to a partner will be allowed as a deduction in the computation of income of the firm.

   (*c*) The total amount allowable in respect of salary, perquisites or allowances to a director or a person having substantial interest or relative of any of these two, shall not exceed Rs. 72,000 p.a.

   (*d*) All cash payments will be disallowed in computing the business income of an assessee if the amount involved is in excess of Rs. 1,000.

   (*e*) In computing the income from business or profession all payments to relatives or associates would be disallowed.

2. Expenditure incurred by an assessee in payment of salary to a former employee would be disallowed in computing the business income of the amount to the extent it exceeds (*a*) Rs. 12,000, (*b*) Rs. 80,000 (*c*) Rs 72,000, (*d*) Rs. 60 000 p.a.

3. The ceiling in respect of salary payable for service within India is fixed at (*a*) Rs. 5,000, (*b*) Rs 6,000, (*c*) Rs. 4,000, (*d*) Rs. 1,000 p.m per employee.

4. The expenditure allowable in respect of perquisites or benefits provided to employees shall not exceed (*i*) ....% of the salary or (*ii*) Rs.................. whichever is less.

   (*i*) (*a*) 30%, (*b*) 25%, (*c*) 20%, (*d*) 15%.

   (*ii*) (*a*) Rs. 1,000, (*b*) Rs. 1,500, (*c*) Rs. 2,000, (*d*) Rs. 2,500 for each month or part thereof.

5. Profits chargeable to tax under Section 41 will be taxed even if the business concern has ceased to exist. This statement is (*a*) right, (*b*) wrong.

6. Carried over losses of defunct business can be set off against deemed profits chargeable under Section 41, This statement is (*a*) right (*b*) wrong

7. Infructuous expenditure incurred in connection with prospecting for mineral oil cannot be claimed as deduction. This statement is (*a*) wrong, (*b*) right

8. The special provisions consequential to changes in the rate of exchange are contained in Section (*a*) 16, (*b*) 23, (*c*) 43A.

9. The profits and gains of insurance business should be computed in accordance with (*a*) Section 28 to 44D, (*b*) First Schedule to the Act, (*c*) Section 56,

10. The deduction under Section 44A on account of any deficiency in the case of a trade association is subject to a limit (*a*) Rs. 3,000 (*b*) 50% of the total income before making allowance under Section 44A, (*c*) Rs. 5,000.

Answers to Self-Examination Questions—I

1. (*b*), 2. (*d*), 3. (*b*), 4. (*d*), 5. (*a*), 6. (*c*), 7. (*c*), 8. (*b*), 9. (*c*), 10. (*d*), 11. (*c*), 12. (*d*) 13. (*b*), 14. (*a*), 15. (*c*), 16. (*i*) (*b*), (*ii*) (*a*), 17. (*c*), 18. (*b*), 19. (*c*) 20. (*a*), 21. (*a*), 22. (*b*), 23. (*d*), 24. (*b*), 25. (*d*), 26. (*d*), 27. (*a*), 28. (*c*), 29. (*b*), 30. (*a*), 31. (*a*), 32. (*c*), 33. (*b*), 34. (*e*), 35. (*c*), 36, (*b*) and (*d*), 37. (*a*) and (*b*), 38. (*d*), 39. (*b*), 40. (*d*), 41. (*a*), 42. (*c*), 43. (*i*) (*b*), (*ii*) (*a*). 44. (*c*), 45 (*b*), 46. (*i*) (*a*), (*ii*) (*a*), 47. (*c*), 48. (*b*), 49. (*i*) (*c*), (*ii*) (*a*), 50. (*d*), 51. (*a*), 52. (*c*), 53. (*b*), 54. (*d*), 55 (*b*), 56. (*d*), 57 (*a*), 58. (*c*), 59. (*a*). 60. (*c*), 61. (*d*), 62. (*b*), 63. (*b*), 64. (*a*), 65. (*c*).

Answers to Self-Examination Questions –II

1. (*a*) False, (*b*) False, (*c*) True, (*d*) False, (*e*) False, 2. (*d*), 3. (*a*), 4. (*i*) (*c*), (*ii*) (*a*), 5. (*a*), 6. (*a*), 7. (*a*), 8. (*c*), 9 (*b*), 10. (*b*).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL I.S.P. (N) I. Tax—6

INTERMEDIATE COURSE

ELEMENTS OF INCOME-TAX LAW

STUDY—VI

This Study Covers :

PART—A

1. Assessment of capital gains
2. Income from other sources
3. Set-off and carry forward of losses

PART—B

1. Total income
2. Income of other persons included in the Assessee's total income
3. Deductions from gross total income
4. Rebates and reliefs
5. Miscellaneous points

Prescribed Readings :

1. Sukumar Bhattacharya's Indian Income-tax Law and Practice, Chapters XII, XIII, XV, and XXII.
2. *Chapters 5 and 13 of* Dr. H C. Mehrotra's Book.

1. ASSESSMENT OF CAPITAL GAINS (Sections 45-55)

1.1 General (Section 45) : A capital gain is income by way of profit and gains arising from the '*transfer of a capital asset*'. Before considering the provisions governing the taxation of capital gains, we must know what exactly the expression, 'capital asset' means under the Income-tax Act.

According to Section 2(14), the expression 'capital asset' means property of any kind held by an assessee, whether or not connected with his business or profession but *does not* include :

(i) stock in-trade, consumable stores of raw materials held for the purpose of the business or profession of the assessee ;

(ii) personal effects *i.e.*, movable property including wearing apparel and furniture but excluding jewellery held for personal use by the assessee or any of his dependent family members ;

(iii) rural agricultural lands in India ; and

(iv) 6½% Gold Bonds 1977, or 7% Gold Bonds 1980, or National Defence Gold Bonds 1980 issued by the Central Government.

(v) Special Bearer Bonds 1991.

Capital assets include goodwill, leasehold rights, a partner's right or share in the firm, a manufacturing licence and the right to subscribe for the shares of a company.

The definition of 'capital asset' includes within its scope agricultural land situated within the limits of any municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or cantonment board having a population of 10,000 or more according to the last census for which the figures have been published before the first day of previous year. Further, agricultural land situated in areas lying within a distance of not more than 8 kilometres from the local limits of such municipalities or cantonement board would also fall within the scope of the definition of 'capital asset' provided that such areas are, having regard to the extent and scope of their urbanisation and other relevant considerations, notified by the Central Government in this behalf. Consequently, any capital gain arising from the transfer of agricultural lands situated in municipal or other urban area or notified adjoining areas will be liable to income-tax. However, under Section 47 (vii) capital gain arising from the transfer of such land effected prior to 1-3-1970 will be excluded from taxation. Agricultural lands situated in rural areas will be outside the scope of this definition and the gains, if any, arising on their transfer would, consequently, be exempt from tax under the Act.

It is to be noted that "jewellery" is treated as capital asset and the profits and gains arising from the transfer of jewellery held for personal use is chargeable to tax under the head 'capital gains'. For this purpose the expression "jewellery". has been defined in the Explanation to Section 2(14) to include—

(*i*) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metal whether or not containing any precious or semi-precious stone and whether or not worked or sewn into any wearing apparel ; and

(*ii*) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

Capital assets are broadly classified into two categories—short-term capital assets and long-term capital assets. According to Section 2(42A), the expression *short term capital asset* means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of transfer. Assets held by the assessee for more than 3 years immediately preceding the date of its transfer will be treated as long-term capital assets. Capital gains arising on the transfer of any short-term capital assets are assessable to tax at the rates applicable to ordinary income whereas gains arising from the transfer of other capital assets (*i.e.*, capital assets other than short-term capital assets) are taxable only in part as they are entitled to deduction under Section 80T read with Twelfth Schedule or concessional treatment under Section 115.

Capital gains can arise only on a transfer of a capital asset. According to Section 2(47) the term 'transfer' in relation to capital assets includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under law. The meaning of the term 'transfer', as given above, has bearing only in relation to capital asset but not in relation to any other context in which the word has been used in the Act.

Section 45 applies not only to the transfer of a specified capital asset but also to a case where the whole of the business undertaking is sold. For the purpose of attracting liability to tax on capital gains, it is not necessary that the assessee himself should voluntarily transfer the capital asset : even a sale by a Commissioner or Receiver appointed by the Court in connection with any other proceeding under any law for the time being in force would be covered by this Section A lease of mines or lands would amount to a transfer and consequently any premium paid for the lease may be assessable as capital gains. But a mere grant of the right of management of a capital asset, would not on its transfer, give rise to capital gains. In order to become taxable, capital gains must have arisen to the assessee directly or indirectly as a result of the transfer of a capital asset. Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability the relevant date of the transfer is not the date of the agreement to sell but the actual date of sale *i e.*. the date on which the effective transfer of title to the property as contemplated by the parties has taken place, [*Alpati Venkataramiah vs. C.I.T. (1965) 57 I.T R. 185 (S C)*] Thus, in the case of any immovable property of the value exceeding Rs. 100, the title to the property cannot pass from the transferor to the transferee until and unless a deed of conveyance is

executed and registered ; mere delivery of possession of the immovable property could not itself be treated as equivalent to conveyance of the immovable property. In the case of any movable property, the title to it would pass immediately on delivery of the property in accordance with the agreement to sell. The date of accrual of capital gains and consequently the liability to tax thereon is essentially the date on which the effective transfer of the capital asset takes place. Further, capital gains as the income of the year in which the transfer takes place, even though they may be realised later or there may be no realisation at all as a result of variation agreed upon in subsequent years. [T.V. Sundaram Iyengar & Sons vs. C.I.T. (1957) 37 I.T.R. 26].

1.2. Calculation of the Period for which a Capital Asset is held : In determining the period for which any capital asset is held by the assessee—

(a) In the case of shares held in a company under liquidation, the period subsequent to the date on which the company goes into liquidation shall not be counted.

(b) In case of shares held in an amalgamated company in lieu of shares in the amalgamating company, the period will count from the date of acquisition of shares in the amalgamating company.

(c) In the case of capital asset which became the property of the assessee in the circumstances mentioned in Section 49 (*i e.*, on partition of a H U.F. inheritance, dissolution of a firm or association of persons), the period for which the asset was held by the previous owner shall also be added to the period for which the asset was held by the assessee in order to determine whether the asset had been held for more than 36 months by the assessee or not.

In respect of capital assets other than those mentioned above the period for which any capital asset is held by the assessee shall be determined subject to any rules which the Board may make in this behalf.

1.3 Capital Gains on Distribution of Assets by Companies in Liquidation (Section 46) : Where the assets of a company are distributed to its shareholders on its liquidation, such a distribution is not to be regarded as a transfer of capital assets by the company to its shareholders. This provision applies only to a distribution of capital assets *in specie* by a company in liquidation, amongst its shareholders. Consequently, capital gains made by the liquidator of a company on sale of the company's assets with the object of distributing the sale proceeds amongst the shareholders, must be assessed as the income of the company. However, a shareholder, on the liquidation of a company, receiving any money or other assets from the company shall be chargeable to tax on the income under the head 'capital gains' in respect of the excess over cost so received in cash or the market value of the assets distributed in kind on the date of distribution as reduced by the amount assessed as dividend, When the shareholder subsequently sells the capital assets which he had received earlier from the company in liquidation, he would be assessable on the excess of sale price realised over the market value of the asset on the date of distribution [Section 55(2 (iii)] provided that he had already paid capital gains tax under this **Section on the market value at the time of distribution.**

If no capital gains tax had been assessed on the shareholder and he subsequently sells or otherwise transfers the capital assets received on the liquidation of the company, he is assessable on the basis of the cost for which the company had acquired the asset together with the cost of any improvement incurred by the company or the shareholder, as the case may be.

1.4 Transactions not regarded as a Transfer : *(Section 47)* : This Section enumerates the circumstances in which the transfer of a capital asset does not result in liability to tax on the capital gains arising as a result of the transfer. The exemptions under this Section would apply only to a distribution of capital assets *in specie* but not to their sale with the object of distributing the sale proceeds. Consequently, capital gains made : (i) by an administrator on the sale of the testator's assets effected with a view to distributing the proceeds of sale amongst the legatees as directed by the will; or (ii) by a Commissioner or Receiver appointed by the Court on the sale of the assets of a dissolved firm would not be exempt from tax under this Section. But in case where, on the dissolution of a firm, one of the partners takes over the whole business and pays the other partners the value in money equivalent to his or their share in the assets, it would be considered to be a distribution *in specie* and would be entitled for the exemption under this Section. The adjustment of the rights of partners in a dissolved firm is neither a transfer nor it is for a price and consequently would not attract liability to tax on the capital gain even in the absense of the provisions of Section 47 (ii).

The cases and circumstances specified as not being regarded as transfer of a capital asset are as under :

(a) any distr bution of capital assets on the total or partial partition of a Hindu undivided family ;

(b) any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons ;

(c) any transfer of a capital asset under a gift or an irrevocable trust ;

(d) any transfer of a capital asset by a holding company to its subsidiary company if (i) the partner company or its nominees hold the whole of the share capital of the subsidiary company ; *and* (ii) the *subsidiary company* is an *Indian company*.

(e) any transfer of a capital asset by subsidiary company to the holding company if ;

  (i) the whole of the share capital of the subsidiary company is held by the holding company ; *and*

  (ii) the *holding company* is an *Indian company*.

(f) any transfer, in a scheme of amalgamation as defined in Section 2(1A) of a capital asset by the amalgamating company to the amalgamated company provided that the amalgamated company is an Indian company ;

(g) any transfer in a scheme of amalgamation by a shareholder of a capital asset being a share or shares held by him in the amalgamating company *only if* :—

(i) the transfer is made in consideration of the allotment to him of any shares in the amalgamated company ; and

(ii) the amalgamated company is an Indian company ;

(h) any transfer of agricultural land in India effected before 1-3-1970 ;

(i) any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, books, manuscript, drawing, painting, photograph or print, in cases where such asset is transferred by the assessee to the Government or a University established or incorporated by or under a Central, State or Provincial Act (including an institution declared under Section 3 of the University Grants Commission Act, 1955, to be a University for the purposes of that Act) or the National Museum, National Art Gallery, National Archives or any other such public institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States.

1.5 **Capital Gains on Sale of House Property exempt from tax : (Section 53) :** Capital gains arising from the transfer of one or more building/s or land appurtenant thereto, the income of which is chargeable under the head "income from house property", is exempt from tax subject to the following two conditions :

(a) the aggregate value of the consideration received from the sale of the property should not exceed Rs. 25,000 : *and*

(b) the aggregate of the fair market value of all such assets owned by the assessee before the above transfer should not exceed Rs. 50,000.

1.6 **Capital Gains on Sale of Residential House (Section 54) :** Income by way of capital gains arising to an assessee from the transfer of a capital asset would be exempt subject, however, to all the following conditions :

(i) The capital asset must be a building or buildings or lands appurtenant thereto and being used as a residential house ;

(ii) The income (actual or deemed) derived from the property must be chargeable to tax as "income from house property" under Section 23.

(iii) The house property should have been used *by the assessee or any of his parents* mainly for the purposes of his own or the parent's own residence for not less than two years immediately preceding the date of its transfer by the assessee. This condition has been omitted with effect from the assessment year 1983-84.

(iv) The capital gains derived on sale of the property should not be exempt under Section 53 as explained earlier.

(v) The assessee must have either constructed within a period of at least two years (three years with effect from the assessment year 1983-84) *after* the date of transfer or within one year *before or after* that date purchased a house property for his *own* residential purposes. For the

assessment year 1983-84, and for subsequent assessment years it is enough if the new house is used for residence. It is not required that it should be used by the assessee for his residence.

If all the above conditions are satisfied, then the capital gains will not be charged to tax as the income of the previous year in which the transfer took place; instead the capital gains shall be dealt with as under :

(*i*) If the amount of the capital gains is greater than the cost of the new asset, the difference between the amount of the capital gain and the cost of the new asset shall be charged as the income of the previous year. Thus, if the amout of capital gain exceeds the amount reinvested only the difference would be chargeable to tax as capital gains. But, if the house property so purchased or constructed is sold away within *three years* from the date of its purchase or completion of construction, as the case by be, the actual cost of the asset to the assessee shall be taken as *nil* and consequently the whole amount received on the second transfer shall be taxable as capital gains.

(ii) If, on the other hand, the capital gain is equal to or less than the cost of the new asset on capital gain would arise to the assessee ; but the cost of the property, if sold within the period of three years, shall be the actual cost *less* the amount of capital gain which was not taxed previously

(iii) In all cases where the capital gain which was initially exempt becomes taxable in a subsequent year or where the capital gain, which was taxable in an earlier year on its becoming due to the assessee becomes exempt in a later year on the assessee complying with the provisions of this Section, the I.T.O. shall make a reassessment in respect of the relevant previous year as if it were a rectification of mistake falling under Section 155 (8).

Where any such house property satisfying the conditions laid down in Section 54, is compulsorily acquired under any law and additional compensation is awarded by any Court, Tribunal or other authority, the capital gain attributable to such additional compensation would be exempted from tax if such additional compensation is utilised by the assessee for the purpose of purchase or construction of a house property for residence within the specified time. The specified period for making the qualifying investment for purposes of exemption in relation to the capital gain attributable to the additional compensation will, in such cases, be determined with reference to the date of receipt of the additional compensation by the taxpayer. The new sub-section (2) of Section 54 provides for this treatment. In such cases, if the regular assessment for the relevant year in which the capital asset was compulsorily acquired had already been completed before the qualifying investment attributable to additional compensation is made by the assessee, the I.T.O. can amend the relevant assessment order under the new Section 155 (8A) so as to exempt the relevant amount of capital gain in cases where the taxpayer has made the qualifying investment within the specified period.

1.7. **Capital Gains on Transfer of Agricultural Land exempt from Tax in certain cases (Section 54B)** : This Section provides for exemption from tax in respect of capital gains arising from the transfer of any land situated in municipal or other urban areas in certain cases.

In order to avail of this exemption (i) the capital assets being land situated within the municipal or other urban areas, must have been used by the assessee or his parents for agricultural purpose during the two years immediately preceding the date of its transfer ; *and* (ii) the assessee must acquire, within a period of two years from the date of transfer, any other land in the same or other area for being used by him or his parent for agricultural purpose.

This exemption corresponds to the exemption in respect of capital gains arising from the transfer of residential houses available under Section 55 and is intended to remove the hardship that may be caused to *bona fide* agriculturists who have to sell or otherwise transfer agricultural land within such limits. The other provisions regarding the treatment of capital gains arising in respect of the new asset or its transfer within a period of three years of its purchase, are similar to those discussed earlier under Section 54.

Where any agricultural land is compulsorily acquired under any law and additional compensation is awarded to the assessee by any court, Tribunal, or other authority, the capital gains attributable to such enhanced compensation will be exempt from tax if the additional compensation is utilised for the purchase of other agricultural land within the specified period. The specified period for making the qualifying investment for purposes of exemption in relation to the capital gain attributable to the additional compensation will in such cases, be determined with reference to the date of receipt of the additional compensation by the taxpayer. The new sub-section (2) of Section 54B provides for this treatment. In such cases if the regular assessment for the relevant year in which the capital asset was compulsorily acquired had already been completed before the qualifying investment attributable to the additional compensation is made by the assessee, the I.T.O. can amend the relevant assessment order under the new Section 155 (9A) so as to exempt the relevant amount of capital gain in cases where the taxpayer has made the qualifying investment within the specified period.

1.8. **Capital Gains arising on the Transfer by way of Compulsory Acquisition of Lands and Buildings exempt from Tax in Certain cases (Section 54D)** : Section 54D has been inserted with a view to providing relief from tax, in the case of person owning industrial undertaking in respect of capital gain arising on compulsory acquisition, under any law, of any land or building used by them for the purpose of the business of the undertaking. The relief under this Section will be available if the following conditions are satisfied :

(i) Capital gain should arise to the assessee on the transfer by way of compulsory acquisition of a capital asset, being land or building or any right in land or building forming part of an industrial undertaking belonging to him.

(ii) Such capital asset must have been used by him for the the purposes of the business of the said undertaking during the two years immediately preceding the date of transfer.

(iii) The assessee must, within a period of three years after the transfer, purchase any other land or building, or any right in any other land and building or construct any other building for the purposes of shifting or re-establishing the said undertaking or setting up another industrial undertaking.

If the above conditions are satisfied, the capital gain will not be charged to tax to the extent it is utilised for purchasing such land, building or right or, as the case may be constructing such building Where the amount of the capital gain exceeds the cost of acquisition or construction, only the excess amount will be chargeable to tax. This concession will, however, be forfeited if the assessee transfers such new land or building within a period of three years from the date of its purchase or construction.

It is to be noted that the relief under this Section will be available even if the assessee purchases or constructs the new asset after the completion of the assessment for the relevant assessment year, but within the specified period of three years. In such cases, even though the capital gain will be included in the assessment of the assessee for the relevant assessment year, the I T.O. will grant this relief subsequently by amending the assessment order under Section 155(10) made by him so as to exclude the amount of the capital gain not chargeable to tax in accordance with this Section.

Sub-section (2) of Section 54 D provides that where any additional compensation is awarded to the assessee by any Court. Tribunal or other authority, the capital gain attributable to such additional compensation is utilised within the specified period for acquisition of asset referred to in Section 54D(1). The specified period for making the qualifying investment for purposes of exemption in relation to the capital gain attributable to the additional compensation will, in such cases, be determined with reference to the date of receipt of the additional compensation by the taxpayer. In such cases, if the regular assessment for the relevant year in which the capital asset was compulsorily acquired had already been completed before the qualifying investment attributable to the additional compensation is made by the assessee, the Income-tax Officer can amend the relevant assessment order under the new Section 155(10)(b) so as to exempt the relevant amount of capital gain in cases where the taxpayer has made the qualifying investment within the specified period.

1.9. Long term capital gains exempt in certain cases Section (54E): It provides for an exemption in respect of capital gain arising from the transfer of a *long term capital assets* in case where the whole or any part of the net *consideration* received or accruing from the transfer is invested or deposited by the taxpayer in specified financial arsets within six months after the date of such transfer. For this purpose, the expression 'net consideration' in relation to the transfer of a capital asset would mean the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly

and exclusively in connection with such transfer. ***If only a part of the net considertion is invested then exemption would be available in respect of the proportionate*** *part of the capital gains.*

In respect of assets transferred after 28th February, 1979 but before 1-3-1983 in order to enjoy the exemption under this provision, the net consideration resulting from the transfer or additional compensation or consideration should be invested only in the 7 year National Rural Development bonds, issued for this purpose.

In the case of original assets transferred on or after 1st March, 1983, no exemption under this section shall be granted unless the assessee has invested or deposited the whole or any part of the net consideration of the 'specified assets' by **intially subscribing to it.** In other words, an assessee cannot claim exemption if he purchases 'such assets' from other person. The term 'specified assets' includes the following in respect of original assets transferred on or after 1st March, 1983.

(i) Securities of the Central Government.

(ii) Special series of units of Unit Trust of India

(iii) National Rural Development Bonds

(iv) Debentures issued by the Housing and Urban Development Corporation Ltd.

Any one of the above mentioned shall constitute specified asset only if the **Central Government notifies in the Official Gazette in this behalf.** It may be noted that this amendment has come into operation with effect from the assessment year 1983-84.

If the new (specified) asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the exemption granted under Section 54E will be withdrawn Section 54 E (2) provides that the amount on which no capital gains tax was levied in the year in which the original asset was transferred will be treated as long-term capital gains of the new (specified) asset is transferred if such transfer is within 3 years.

As per new explanation 2 added to sub-section 2, if an assessee takes any loan or advance on the security of such new (specified) assets it shall be deemed that he has converted such new asset otherwise than by transfer. Consequently, in cases where such loan or advance is taken within a period of 3 years from the date of acquisition of the new asset, the amount of capital gain originally exempted on the basis of the cost of the new asset will be changed to tax in the accounting year in which such loan or advance is taken. This explanation however applies only in respect of original assets tranferred on or after 1st March, 1983 and it is effective fromthe assessment year 1983-84.

If the period of six months for reinvestment has not ended before the date of completion of assessment and the assessee has made the investment in the specified asset after the assessment for the relevant year has been completed by the I.T.O. the exemption under section 54E would be allowed by amending the assessment order made by him. Clause (10A) of Section 155 provides for such amendment within 4 years from the date of the assessment order.

The sub sections (3), (4), (5) and (6) of Section 54E provide that where a capital asset, not being a short-term capital asset, is transferred by way of compulsory acquisition or where the consideration for the transfer of the capital asset is determined or approved by the Central Government or the Reserve Bank of India and subsequently additional compensation is awarded by any court, Tribunal or other authority, the capital gain attributable to such additional compensation would be exempt from tax, if such additional compensation is invested or deposited within the specified period in the specified asset referred to in Section 54E. The specified period for making the qualifying investment for purpose of exemption in relation to the capital gain attributable to such additional compensation will in such cases be determined with reference to the date of receipt of the additional compensation by the taxpayer.

In such cases, if the regular assessment for the relevant year in which the capital asset was compulsorily acquired, had already been completed before the additional compensation is invested in the specified investments by the assessee, the Income-tax Officer can amend the relevant assessment order under the new Section 155 (10B) so as to exclude the relevant amount of capital gains in cases where the taxpayer has made the qualifying investment within the specified period.

It may be noted that the concession under Section 54E can be claimed only in respect of long-term capital gains while the concessions under Sections 54, 54B and 54D are available to both long-term and short-term capital gains. Similarly, the new Section 54E will also cover assets in respect of which Sections 54, 54B and 54D are applicable but concessions under the said Sections are not available for any reason.

Illustration : Mr. Sekhar has transferred jewellers for Rs. 1,55,000 on 1st May 1983. He incurred incidental expenditure of Rs. 5,000 in connection with the transfer. He purchased the jewellery in 1970 for Rs 30,000. Mr. Sekhar invested Rs. 1,00,000 in National Rural Development Bonds in August 1983. Compute the amount of taxable capital gains to be included in his Gross Total Income for the assessment year 1984-85.

Answers :

Jewellery constitutes 'capital asset' within the meaning assigned to it under Sec 2(14). Since the jewellery was held by Mr. Sekhar for about 13 years, it shall be a long-term capital asset under Section 2 (42A). Let us compute long-term capital gains arising on transfer of the jewellery.

Computation of Capital Gains in the hands of Shri Sekhar for the Assessment year 1984-85.

	Rs,
Consideration	1,55,000
Less : Expenses incurred on transfer	5,000
Net consideration	1,50,000
Less : Cost of acquisition	30,000
Capital gains	1,20,000

Since Mr, Sekhar invested Rs. 1,00,000 of consideration in August, 1983 i.e. within six months from the date of transfer in National Rural Development Bonds, he would be entitled to exemption under Section 54E in respect of gains arising from long-term capital asset. He should subscribe initially to these Bonds and he should not buy from any other person. The amount of exemption that would be available to Mr. Shekhar is Rs. 80,000 $\left[\frac{\text{Rs } 1,00,000}{\text{Rs } 1,50,000} \times \text{Rs. } 1,20,000\right]$. *Hence the amount of taxable capital gains to be included in his Gross Total Income shall be Rs. 40,000 (Rs 1,20 000 - Rs. 80,000).*

1.10 ***Exemption of capital gains in cases of investment in residential houses [Section 54F]*** Section 54F provides that in the case of an assessee *being an individual the long term capital gains arising from the transfer of an asset will be exempt* from income-tax if he has within a period of *one year before or after* the date on which the transfer took place *purchased* or within a period of *three years after that date constructed* a residential house by utilising the net consideration in respect of such transfer. The exemption of the long-term capital gains will be granted proportionately on the basis of the investment of net consideration either for the purchase or construction of the residential house in the cases where a part of the net consideration is used for this purpose. This concession will not be available in a case where the assessee owns on the date of the transfer of the original asset any residential house other than the new residential house in respect of which exemption is sought to be claimed under this Section, or purchases, within the period of one year after such date or constructs, within the period of three years after such date, any residential house other than the new residential house in respect of which exemption is sought to be claimed under this Section. Where the assessee so purchases or constructs a residential house, the capital gains, i. not, charged to tax either, will be charged to tax as long-term capital gains of the year in which the house is so purchased or constructed.

Where the new residential house is transferred within a period of three years from the date of its purchase or its construction, the amount of capital gains arising from the transfer of the original asset which has not been charged to income-tax will be deemed to be long-term capital gains of the previous year in which the new asset is transferred.

The above provision is effective from 1st April, 1983 and shall accordingly apply in relation to the assessment year 1983-84 and subsequent years.

1.11 Computation of Capital Gains (Section 48 to 52 and 55)

(a) *Method of computation (Section 48)* : The income chargeable under the head 'capital gains' must be computed by deducting the following two items from the full value of the consideration received or receivable by or accruing to the assessee as a result of the transfer of the capital asset, *viz.*

(i) expenditure incurred by the assessee wholly and exclusively in connection with the transfer (*e.g.*, stamp duty, registration charges, *etc*); and

(ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

Capital gains should, like business profit, be computed in accordance with the ordinary principles of commercial accounting as was held in *D un Dadhubhoy Kapadia vs. C.I.T. (1967) 63 I T R. 651 (S C.)* For instance, while computing the capital gains on sale of right shares, the fall in the market value of the original shares consequent upon the issue of right shares must be taken into account. Recently, the Supreme Court held in *C I.T. & B C. Srinivasa Setty (1981) 5 Taxman, 1*, that in a case where the capital asset does not have a cost of requisition there cannot be capital gains on its transfer under Section 45. This decision was rendered in the context of self generated goodwill. However, it has been follow*ed in the case* of other self-generated assets like tenancy rights, *import entitlements, patent rights*, etc. wherever there is no cost of acquisition.

(b) *Cost of Acquisition* : The expression "cost of acquisition" in relation to a capital asset has been defined in Section 55(2). According to the definition the meaning of the phrase is to be taken as under :

(i) Where the capital asset became the property of the assesee prior to 1-1-1964, the cost of acquisition shall be either the actual cost of its acquisition by the assessee of the fair market value of the assets on 1-1-1964, whichever the assessee opts for.

(ii) Where the capital asset becomes the property of the assessee under any of the modes specified in Section 49(1) i.e , succession, inheritance, devolution, etc. and the capital asset was acquired by the previous owner prior to 1-1-1964, the cost of acquisition of the assets to the assessee shall be taken to be the actual cost of the capital asset to the previous owner or the fair market value of the asset on 1-1-1964, at the option of the assessee.

However, where the cost for which the previous owner acqui ed the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date which the capital asset became the property of the previous owner [Section 55(3)]

(iii) Where the capital asset became the asses ee's property on the distribution of capital assets of a company on its liquidation and the assessee has been assessed to tax under the head 'capital gains' in respect of that asset under Section 46, the cost of acquisition to the assessee shall be taken to be the fair market value of the asset on the date of its distribution by the company.

(iv) Where the capital asset being a share or stock of a company became the property of the assessee on—

(a) the consolidation and division of all or any of the share capital of the company into shares of a larger amount than its existing shares ;

(b) the conversion of any shares of the company into stock ;

(c) the conversion of any stock of the company into shares ;

(d) the sub-division of any shares of the company into shares of a smaller amount ; or

(e) the conversion of one kind of shares of the company into another kind, the cost of acquisition must be taken to be the actual cost of acquisition of the shares or stock from which such asset is derived by the assessee.

(c) *Cost of Improvement :* According to Section 55 (1) (b) the expression 'cost of any improvement' in relation to capital asset has the following meanings :

(i) Where the capital asset became the property of the previous owner or the assessee before 1-4-1964 and the fair market value of the asset on the date is taken as the cost of acquisition at the assessee's option, then the cost of any improvement to the asset means all the expenditure of a capital nature incurred in making any additions or alterations to the capital asset after 1-1-1964 by the previous owner or the assessee.

(ii) In any other case, the cost of any improvement to the asset means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset by the assessee after it became his property or by the previous owner [if the asset became the property of the assessee by any of the modes specified in Section 49 (1)], as the case may be.

But the cost of improvement to a capital asset shall not include any expenditure which is deductible (whether actually deducted or not) in computing the income from interest on securities, income from house property, profits and gains of business or profession or income from other sources and the expression "improvement" will have to be constructed accordingly.

(b) *Cost with Reference to certain Modes of Acquisition* (*Section 49*) : In cases where the capital asset became the property of the assessee—

(a) on any distribution of asset on a total or partial partition of a H U.F. ;

(b) under a gift or a will ;

(c) by succession inheritance or devolution ;

(d) on any distribution of assets on the dissolution of a firm, a body of individuals or other association of persons ;

(e) on any distribution of assets on liquidation of a company ;

(f) under any transfer to an irrevocable trust ;

(g) under any transfer by a holding company to its 100 % subsidiary or *vice versa* ;

(h) under a scheme of amalgamation by the amalgamating company to the amalgamated company ;

(i) by conversion by an individual of his separate property into H U.F. property.

then the cost of acquisition of the assets shall be deemed to be the cost for which the *previous owner* of the property acquired it, as *increased by the cost of the improvement* to the asset incurred or borne by the *previous owner or the assessee*, as the case may be.

Where a capital asset became the property of the assessee on any distribution of assets on the total or partial partition of a H.U.F. or under a gift or will or under succession, inheritance, devolution *etc.*, *the cost of acquisition of the asset to the previous owner of the property is the cost of acquisition to the latest previous owner who acquired the asset otherwise than by any of the modes of acquisition specified above.*

Likewise, where a capital asset being a share or shares in an amalgamated company became the property of the assessee in consideration of the transfer of a share or shares held by him in the amalgamating company under a scheme of amalgamation, the cost of acquisition to him of the share or shares in the amalgamated company shall be taken to be the cost of acquisition to him of the share or shares in the amalgamating company.

In a case where the asset became the property of a H.U.F. by the mode referred to in Section 64 (2), *i.e.*, where an individual converted his separate property into H U.F. property the cost of the converted property to the H.U.F. would be the cost to the individual who made such conversion.

Capital gains generally must be computed after deducting from the sale price the cost of acquisition to the assessee. The various provisions aforementioned form an exception to this general principle by providing that the cost to the previous owner shall be deemed to be the cost of acquisition to the assessee.

Assets having no cost of Acquisition :

(a) **Goodwill generated in a newly commenced business**—

Recently, the Supreme Court has held that the goodwill generated in a newly commenced business cannot be subject to income-tax under the head, 'Capital Gains' on its transfer. This judgment sets at rest the various conflicting judicial decisions in this regard. The judgment was delivered in the case of *C I.T. Vs B.C. Srinivasa Setty* and several other taxpayers who intervened *(1981) 5 Taxman I (S C)* The Supreme Court held that what is contemplated in the relevant provisions (i e. Section 45 to 55) is an asset in the acquision of which, it is possible to envisage the cost. Therefore, goodwill generated in a new business cannot be regarded as such an asset. The decision will have far reaching consequences in as much as it will also have application with reference to other types of self-generated assets such as tenancy rights, import entitlements, patents, etc., not having cost of acquisition as such.

(b) *Purchased Goodwill* -The Bombay High Court held in *Evans Fraser & Co Ltd. v. CIT (1981) 25 CTR 128 (Bom)* that even the assessee who had purchased the goodwill for a price along with the acquisition of the business would *not be* liable to tax on selling the same as it is not possible to ascertain the cost of addition or alteration to the quality of goodwill which is a fluctuating thing.

(c) *Import Entitlement*—No capital gains liable to tax shall arise on the sale of import entitlements gained on exports as held in *Addl CIT v K S Sheik Mohideen (1978) 115 ITR 243 (Mad)* ; *Non-such Tea Estates Ltd. v. CIT (1981) 129 ITR 28 (Mad)* **and approved in *CIT v B.C. Srinivasa Setty's* case.**

wi[illegible] ... that [illegible]
he [illegible] ... bases etc
from [illegible] ... Cost of Acquisition : On transfer of loom ho[illegible]
he s[illegible] ... transferee, no taxable capital gains arise as he[illegible]
[illegible] ... CTR (Cal) 300.

(f) *Special Provisions for Computing the Cost of Acquisition in the case of Depreciable Assets (Section 50)* : This Section provides another exception, to the general rule that capital gains must be computed after deducting from the sale price the cost of its acquisition. In the case of depreciable assets, the written down value arrived at after deduction of all the depreciation (including initial depreciation) allowable as adjusted by the amount of terminal allowance or balancing charge must be deemed to be cost of acquisition The adjustment must be with reference to the terminal depreciation actually allowed or the balancing charge actually levied and not merely the amount allowable. If, however, for any reason no balancing charge or depreciation is actually levied or allowed thereon the written down value shall be taken without any increase or diminution [Section 55 (1) (a)]. Further, where the fair market value of an asset on 1-1-1964 is to be taken into account, at the option of the assessee under Sections 49 and 55 (2) then the cost of acquisition of the asset shall be the fair market value of the said date *minus* the amount of depreciation, if any, allowed to the assessee after that date as adjusted.

In case where the asset was on any previous occasion the subject-matter of negotiation for transfer, any advance or other moneys received and retained by the assessee in respect of such negotiations should be deducted in computing the cost of its acquisition to the assessee (Section 51].

(g) *Consideration for Transfer in cases of Understatement (Section 52)* : In cases where (i) the transferee is a person with whom the assessee is idirectly or indirectly connected ; and (ii) I.T O. has reason to believe that the transfer was effected with a view to avoiding or reducing the liability of assessee to tax on the capital gains, the full value of the consideration for the transfer shall be taken to be the fair market value of the capital asset on the date of the transfer. But before deciding the fair market value to be the full value of the consideration under this Section, he must get the prior approval of the Inspecting Assistant Commissioner.

However, if in the opinion of the I.T O. the fair market value of the capital asset on the date of the transfer exceeds the full value of the consideration declared by the assessee in respect of the transfer by the not less than 15% of the value so declared, the full value of the consideration shall with the prior approval of I.A.C, be taken to be the fair market value on the date of the transfer. The purpose of introducing these provisions is to provide an alternative means for ensuring that no avoidance of tax takes place ; hence, this Section provides for revalution of the asset by the I T.O.

It is to be noted that the aforesaid provision is not applicable to cases where the capital asset is transferred to the government or where the full value of the

consideration for the transfer of the capital asset is determined or approved by the Central Government or the Reserve Bank of India.

In view of the Supreme Court's decision in *K.P. Varghese v. ITO (1981) 131 ITR 597 (SC)*, if a person transfers any capital asset for no consideration or inadequate consideration and declares right amount of consideration received, the Income Tax Officer cannot invoke the provisions of Sec. 52 even if the market value of such asset as on the date of transfer was much higher than the consideration received.

Reference to Valuation Officer (Section 55A) : The Section provides that the I.T.O. may refer the valuation of the capital asset to a Valuation Officer for the purpose of ascertaining the fair market value of a capital asset for the purpose of taxing capital gains The reference could be made in cases where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the I T O is of opinion that the value so claimed is less than its fair market value In other cases the reference could be made if the I.T.O. is of the opinion that fair market value of the asset exceeds the value of the asset claimed by the assessee or by more than Rs. 25,000. The reference could also be made in cases where I.T O. is of the opinion that it is necessary to do so having due regard to the nature of the asset and other relevant circumstances.

2. INCOME FROM OTHER SOURCES (Sections 56 to 59)

2.1 General (Sec. 56) : Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head "Income from other sources". The head, thus, is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. In consequence when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provision of the Act, it would be charged under this head.

Sub-section (2) specifically provides that dividend income, casual income and income from the letting of machinery, plant or furniture, belonging to the assessee when the letting of the building is inseparable from that of the plant or machinery and furniture shall be treated as income chargeable under this head provided that the income is not otherwise taxable as income from business or profession and shall not be computed in accordance with the provisions of Sections 57 and 58 The word 'dividend', as defined in Section 2(22), includes any dividend declared, distributed or paid within the meaning of the definition (discussed in Study Paper I) and will be deemed to be the income of previous year in which these are declared, distributed or paid. Some of the other incomes that would be assessed under this head are director's fees, interest earned on any deposits : or loans on current accounts or securities other than those to which Section 18 of the Act, applies, rent other than rent of house property, royalties, fees, commission tips and annuities.

Income from royalties and copyright fees for literary or artistic work are also chargeable under this head. Under Section 180 a relief has been granted to

authors of literary or artistic work by providing that the amount of taxable income in their hands can be allocated, at their option, over a period of three years in order that it may bear tax at lower rate than the normal rate of tax which might be attracted if the entire amount were to be charged as the income of a single year. Rule 9(2) of the Income-tax Rules, 1962 prescribes the mode of spreading the income covered by this Section over three years.

2.2 **Deductions allowable** (Section 57) : The income chargeable under this head, whatever be its source, shall be computed after making allowance for any expenditure (not being in the nature of a capital or personal expenditure) incurred during the accounting year solely for the purpose of making or earning such income When the income chargeable under this head, consists of dividends, the same shall be computed after making an allowance for any reasonable sum paid by way of commission or remuneration to a broker or agent or any person for collecting them on behalf of the assessee.

In the case of a foreign company, no deduction under the Section will be allowed on computing its income by way of dividends.

Where the income falling to be charged under this head is from letting on hire of machinery, plant or furniture, the following items of deductions would be made in the computation of such income :

(a) the amount paid on account of any current repairs to the machinery, plant or furniture [Section 30 (a) (ii)];

(b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture [Section 30 (c)]:

(c) the normal depreciation allowance in respect of the machinery, plant or furniture and obsolescence allowance if any, due thereon.

The allowances are to be regulated in accordance with the provisions of Sections 30 (a), 30(c), 31 and 32(2) and are subject to the provisions of Sections 34 and 38.

If it is found that for the purpose of earning the aforesaid income, it is inevitable for the assessee to let on hire some buildings also, then all the allowances enumerated above shall be made in respect of the buildings as well.

In computing the income under this head, a deduction is to be made in respect of expenditure incurred during the accounting year solely for the purpose of earning such income provided that the expenditure is not in the nature of a capital expenditure or personal expenses of the assessee.

The Supreme Court held in *C.I.T. v. Rajindra Prasad Moody (1978) 111 I.T.R. 159*, that in order to claim deduction under Section 57 (iii) in respect of any expenditure, it is not necessary that income should in fact have been earned as a result of the expenditure. In this view of the matter the court held that the interest on money borrowed for investment in shares which had not yielded an dividend was admissible as a deduction under Section 57 (iii) in computing its income from dividend under the head "Income from other sources".

2.3 Deductions not allowable (Section 58) : No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses :

(a) *In the case of an assessee—*

(i) any personal expenses of the assessee ;

(ii) any interest chargeable to tax under the Act which is payable outside India (other than interest on a loan issued for public subscription before 1-4-1938 on which tax has not been paid or deducted at source and in respect of which there is no person in India who may be treated as an agent under Section 163 for being assessed in his representative capacity ;

(iii) any payment taxable in India as salaries if it is payable outside India unless tax has been paid thereon or deducted at source ; and

(b) *In the case of a company* the disallowance will be applicable to any expenditure of the nature specified in Section 40(c) resulting in the provision of any benefit, amenity or perquisite to a director or a person having substantial interest in the company or a relative of either of these two persons which in the opinion of the I.T.O. is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom, irrespective of the consideration whether or not such amount is included in the total income of any such person.

In addition to these disallowances, sub-section (2) of Section 58 specifically enacts that the provision relating to the disallowance of payments to relatives and associate concerns, payments exceeding Rs 2,500 made otherwise than by crossed cheques or drafts and ceiling on managerial remuneration in excess of Rs. 72,000 or Rs. 60,000, as the case may be covered by Section 40A will be applicable to the computation of 'income from other sources' as well.

Sub-section (3) in Section 58, has been inserted with effect from 1st June, 1976. It provides that in the case of a foreign company, the provisions of Section 44D would also be applicable for the purposes of computation of income chargeable under the head "income from other sources".

2.4 Profits chargeable to Tax (Section 59) : The provisions of Sections 41 (1) and (2) are made applicable, as far as possible, to the computation of income under this head also. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability, the recoupment of such loss or expenditure or the remission or cessation of the liability in a subsequent year shall be deemed to be the income of that latter year. Further, a balancing charge is leviable in respect of buildings, machinery, plant or furniture, the rental income of which is assessable under Section 56 (2)(ii) as income under this head since the depreciation on these assets is allowable as a deduction under Section 57 (ii).

3. SET-OFF AND CARRY FORWARD OF LOSSES (Sections 74 to 80)

3.1 **General :** Since "Income tax is only one tax and there are not as many taxes as there are heads of income" it is essential that a loss sustained in any year under one head of income should be set off against the income under any other head in the same year in order to arrive at the true and correct total income of the assessee on which tax is payable. Even before ascertaining the amount of loss under one head, the assessee must deduct or set off the loss incurred by him under the same head from the same source or from different sources.

3.2 **Set-off Losses against Income under the same Head (Section 70) :** Under this Section the loss incurred by the assessee in respect of one source the income from which is taxable under the Act shall be set off against income from any other source under the same head of income since the income under each head is to be computed by lumping together the net result of the activities of the source covered by that head. Thus, an assessee can set off his business losses against income from profession or against income from any other business in the same year as all these sources of income fall under one head of income. Therefore, the loss in a business may be set off against the profits of same year in another business even though the business in which the loss was incurred may have been carried on only for a short period during the accounting year and discontinued within the same year. This rule, however, is subject to three exceptions, *viz.*

(i) a loss in speculation business can be set off only against the profits of any other speculation business but not against any other business or professional income ;

(ii) a loss in lotteries can be set off only against income from lotteries but not against any other item of casual income. This principle would apply to all items of losses from sources the income of which is covered by Section 2 (24) (ix) [*i.e.*, crossword puzzles, races, card games, gambling or betting] ; and

(iii) a loss in respect of a long-term capital asset can be set off only against the income in respect of any other long term capital asset.

The cases are discussed later in detail under their appropriate heads.

3.3 **Set off of Losses against Income under any other Head (Section 71) :** After setting off the losses against income under the same head, if the net result is still a loss, the loss so computed under that head of income can be set off against the income under any heads in the same year. Thus, a business loss can be set off against income from house property or interest on securities; similarly a loss under the head "income from other sources" can be set off against business income or capital gains. The three exceptions specified in the preceding paragraph hold good in this case also ; hence, a long-term capital loss or a speculation loss cannot be set off against income under any other head in the same year. A loss relating to short-term capital asset can be set off against income under any other head in the same year. However, if the loss relates to income assessable under any of the heads other than 'capital gains' and the assessee under the head 'capital gains' then he shall be entitled to have the amount of such loss set off against income under any other head assessable for the same assessment year. In other words, if the assessee has

income relating to capital gains (short-term or long-term) he can set off his loss under the other heads against the capital gains. The assessee is also given the option to set off such losses (other than those relating to capital assets) only against short-term capital gains and income under other head. Thus, short-term capital losses or gain have to be treated in the same way as other income.

3.4 Carry Forward and Set-off of Business Losses (Section 72 and 80) : Under the Act the assessee has the right to carry forward the loss in case where it cannot be set off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set off against the profits of subsequent assessment year. The different items of loss which an assessee is entitled to carry forward relate to—

(i) unabsorbed depreciation ; (ii) unabsorbed development rebate/investment allowance ; (iii) unabsorbed development allowance ; (iv) unabsorbed capital expenditure on scientific research ; (v) losses in speculation business ; (vi) losses in any other business or profession ; (vii) losses under the head capital gains ; and (viii) losses of a casual nature attributable to races including horse races. The carry forward and set off of unabsorbed depreciation, development rebate, development allowance, investment allowance and capital expenditure on scientific research are covered by their relevant Sections and have been discussed earlier at their appropriate places in Study Paper V.

This Section, *i.e.*, Section 72, covers only the carry forward and set-off of losses arising from a business or profession. The loss, if any, incurred by an assessee under the heads, 'income from house property', 'interest on securities' or 'income from other sources' cannot be carried forward and set off in subsequent years under any circumstances. Carry forward of losses under the head "capital gains" is governed by the provisions of Section 74.

The assessee's right to carry forward business losses under this Section however, is subject to the following conditions :—

(i) the loss should have been incurred in a business, profession or vocation.

(ii) The loss should not be in the nature of a loss in the business of speculation which must be treated separately.

(iii) The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred. But a loss carried forward cannot, under any circumstances, be set off against the income from any source other than business or profession. However, in cases where shares are held by an assessee as part of his stock-in-trade in his capacity as a dealer in shares, the dividend from those shares would form part of the income from business of the assessee although computed under the head. 'income from other sources' in view of the specified provision in Section 56 to this effect. Likewise interest on securities which are held as stock-in-trade of the assessee would constitute business income though it would be computed under the head 'interest on securities.' If the assessee, who is a dealer in shares,

has got brought forward losses in that business, computed under the head 'profits and gains of business or profession' such losses could be set off in the subsequent eight years against the dividends from shares and the interest on securities which are held by him as his stock-in-trade. The principle have been laid down by the Supreme Court in the cases of *Western States Trading Co. (P) Ltd. vs C.I.T. (1971) 80 I T R. 21 and C I.T. vs. Cocanada Radhaswami Bank (1965) 47 I.T.R 306.*

(iv) The business or profession in which the loss was incurred must continue to be carried on by the assessee in the previous year in which the loss is claimed to be set off. In other words, the loss of a discontinued business cannot be carried forward or set off in any year later than the year of cessation of the business. The rule is, however, subject to the exception embodied in Section 41 (5) under which the profits of a discontinued business will be assessed as profits chargeable to tax only after setting off against losses (not being in speculation business or under the head 'capital gains') which arose during the previous year in which the business ceased to exist and which could not be set off against any other income of that previous year.

(v) The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is it is only the person who has incurred the loss who is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor *except* in the case of succession by inheritance. Also, an amalgamated company cannot carry forward and set off the losses incurred by the amalgamating company even if the amalgamation falls within the definition of the term given in Section 2(1A). This rule also is now subject to the provisions of new Section 72 A, which is effective from 1st April, 1978.

(vi) A business loss cannot be carried forward for a period which is more than *eight* years from the end of the previous year in which the loss was incurred.

(vii) In order to carry forward or set-off of a loss the assessee must have filed a return of loss under Section 139 in accordance with the provisions of Section 80. In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the loss sustained by him. For this purpose, it is immaterial whether the return of loss was filed voluntarily or after receiving a notice from the I.T.O. or after the prescribed time.

(viii) The assessee can carry forward only such an amount of loss as has been determined by the I.T.O. and not disputed by him (*i e.*, the assessee) he cannot claim to carry forward the entire amount of loss returned by him.

(ix) According to the proviso to Section 72 (1) in the case of a business which is discontinued and subsequently revived, thereby entitling the assessee to a deduction on account of rehabilitation allowance under Section 33B, the provision aforementioned relating to the continuance of the business and the period of carry forward of the loss will be relaxed by three years.

Sub-section (2) of Section 72 specifically provides that losses which have been carried forward from past years must first be set-off against the business profits under this Section ; unabsorbed depreciation allowance of past years carried forward under Section 32(2) should be set off only against the balance of such profits. In other words, carried forward business loss should be adjusted in priority over the carried forward unabsorbed depreciation.

Carry-forward and Set off of Losses and unabsorbed Depreciation in certain cases of Amalgamation : Section 72A, which is effective from 1st April, 1978 (assessment year 1978-79), seeks to facilitate the merger of sick industrial units or sick shipping units with sound ones by providing that if a sick unit merges with a sound unit the benefit of carry-forward and set off of accumulated losses and unabsorbed depreciation of the sick unit will be allowed if the conditions laid down in the new Section 72A are complied with. Under the provisions of Section 72A, where there has been an amalgamation of company [as defined in Section 2(1A)] of the Income-tax Act owning an industrial undertaking or a ship with another company and the Central Govt. on the recommendation of the specified authority, is satisfied that certain conditions specified in this behalf are fulfilled, the Central Government may make a declaration to that effect and thereupon, notwithstanding anything contained in any other provision of the Income-tax Act the accumulated loss and unabsorbed depreciation of the amalgamating company shall be *deemed to be* the loss or as the case may be, allowance for depreciation of the amalgamated company *for the previous year in which the amalga nation was effected* and other provisions of the Act relating to carry forward result and set off of loss and allowance for depreciation shall apply accordingly. As a result of this deeming, provision, the unabsorbed loss of the amalgamation is deemed to be the loss for the previous year in which the amalgamation was effected company and the amalgamated company will have the right to carry forward the loss for a period of eight assessment years immediately succeeding the assessment year relevant to the previous year, in which the amalgamation was effected. In the absence of this specific provision, the amalgated company would not be able to carry forward and set off against its profits the accumulated business loss and unabsorbed depreciation allowance of amalgamating company. This is because of the fact that under the Income-tax law of our country only the assessee who incurred the loss has the right to carry forward the same so that the successor in business cannot claim to carry forward the loss incurred by the predecessor. Since the amalgamation involves succession, in the absence of this new provision, the right to carry forward the loss will be lost.

The Central Government will make the declaration under the new provision only if it is satisfied that the amalgamating company was not, immediately before such amalgmation, financially viable by reason of its liabilities losses and other relevant factors and that the amalgamation was in the public interest. The Central Government has also power to specify such other conditions in this behalf as would ensure that the benefit under this provision is restricted to amalgamations which would facilitate rehabilitation or revival of the business of the amalgamating companies.

The Central Government have notified an Inter-Ministerial Committee under th Chairmanship of Secretary of the Department of Industrial Development. Ministr

of Industry, with membership of Secretaries of the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, Ministry of Labour, Department of Expenditure, Ministry of Finance and Chairman, Central Board of Direct Taxes as the specified authority for the purposes of this provision. The Government have also announced certain guidelines for determining whether mergers of sick units with healthy would be in the public interest and whether in such cases the losses and unabsorbed depreciation of the sick units should be deductible in the hands of assessment of the healthy unit.

The amalgamated company has to satisfy certain further conditions in order to avail of the benefit of set off of the accumulated loss and unabsorbed depreciation During the previous year relevant to the assessment year for which such set off or allowance is claimed the business of the amalgamating company should be carried on by the amalgamated company without any modification or reorganisation or with such modification or reorganition as may be approved by the Central Government. The amalgamated company should also furnish along with its return of income for the assessment year for which such set-off or allowance is claimed, a certificate from the specified authority to the effect that adequate steps have been taken by that company for the rehabilitation of the business of the amalgamating company.

The Finance Act, 1978 has inserted a new sub-section (3) in Section 72A to incorporate a specific provision to enable the concerned companies to obtain an 'advance ruling' in this regard from the specified authority. Under this provision the specified authority would examine the proposed scheme of amalgamation submitted to it and take into account all relevant facts to satisfy itself whether the conditions referred to in Secton 72A would be fulfilled if such amalgamation is effected in accordance with such a scheme. The specified authority is also being authorised to indicate such modifications in the proposed scheme of amalgamation as it considers necessary. Where after examining the scheme and taking into account all relevant facts, the specified authority is satisfied that the conditions referred to in Section 72A will be fulfilled if such amalgamation is effected in accordance with such scheme (or in accordance with such scheme as modified in the manner indicated by it), the said authority would intimate to the co mpany which has submitted the scheme of amalgamation that after the amalgamation is so effected, it would make unless there is any material change in the relevant facts, a recommendation to the Central Government under Section 72A. This new system of advance ruling is also effective from 1st April, 1978.

The term 'accumulated loss' for the purpose of this provision means so much of the loss of the amalgamating company under the head 'profits and gains of business or profession', not being loss sustained in a speculation business, which the amalgamating company would have been entitled to carry forward and set off under the provisions of Section 72 if the amalgamation had not been effected, Similarly, 'unabsorbed depreciation' means so much of the allowance for depreciation of the amalgamating company which remains to be allowed and which would have been allowed to the amalgamating company under the provisions of the Income-tax Act, if the amalgamation had not been effected.

3.5. Losses in Speculation Business (Section 73) : The meaning of the expression 'speculative transaction', as defined in Section 43 (5) and the assessability of income from speculation business have already been discussed under the head

'profits and gains of business or profession'. Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor carried forward and set off against other profits in the subsequent years. Therefore, the loss sustained by an assessee in a speculation business can be set off only against the income of the same year from any other speculation business ; if the loss cannot be set off in the same year it can be carried forward to subsequent years and set off against income from *any* speculation business carried on by the assessee. Similarly, an assessee, who incurred loss in a business of speculation carried on by him individually, is entitled to set it off against his share of the profit of another speculation business carried on by a firm of which he is a partner. This Section thus provides an exception to the rule that the assessee must carry on the business in which the loss originally incurred in the year in respect of which the loss is claimed to be set off. Like any other business, the loss in speculation business can be carried forward only for a maximum period of *eight* years from the end of the relevant assessment year in respect of which the loss was computed. The loss in speculation may also include the loss on account of bad debts irrecoverable profits and interest on borrowings. The other provisions in relation to the carry forward of business losses will, as far may be, apply to the losses in speculation business as well.

The Explanation to Section 73 seeks to treat the business of purchase and sale of shares by companies which are not investment, banking or finance companies, as speculation business. The result of this would be that losses from such dealings will be set off only against gains from similar dealings in shares.

3.6. Losses under the Head 'Capital' Gains (Section 74) : As explained earlier for all purposes of assessment and set-off, capital gains classified into short-term and long-term capital gains. The provisions in regard to the carry forward and set off of losses ascertained, under the head 'capital gains' are as under :

Losses relating to short-term Capital Assets :

(i) A loss relating to short-term capital assets may be set off in the same year against capital gains attributed to any capital assets whether short-term or long-term.

(ii) If it cannot be so set off, it can be seen] against] income under any other head in the same year.

(iii) Where the short-term capital loss cannot be set-off in same year, wholly or in part, it can be carried forward for a maximum period of *eight* years and set off against capital gain relating only to short-term capital assets.

Losses relating to long-term Capital Assets :

(i) A loss attributable to long-term capital assets can be set off in the same year *only* against long term capital gains.

(ii) Under no circumstances can it be set off against short-term capital gains or other incomes including income from speculation.

(iii) A loss which cannot wholly or partly be set off in the same year as aforesaid can be carried forward for a maximum period of *four* years and set off *only* against capital gains relating to long term capital assets. According to the provision to Section 74 (1) (a), the right of any assessee (other than the company) to carry forward the net loss attributable to any long-term capital assets, in any year can be exercised only if the loss exceeds Rs. 5,000. In other words, a non-corporate assessee cannot carry forward a long-term capital loss if it is less than Rs. 5,000.

3.7. **Losses of casual nature under the head 'Income from other Sourees' (Section 74A)** : Section 74A provides specifically that in cases where the net result of the computation made for any assessment year in respect of any of the following sources falling under the head 'income from other sources' is a loss, the loss so computed shall be set off against income from the *same* source. The six sources, the losses which are to be taken into account for this purpose are :

(i) lotteries ; (ii) crossword puzzles ; (iii) races including horse races (iv) card games, (v) other games of any sort ; (vi) gambling or betting of any form or nature whatsoever not covered by items (i) to (v).

For the purposes of the set off of losses each one of these sources must be deemed to be separate and distinct from one another. Consequently, losses incurred from these sources will be set off-only against income, if any, from the same source ; the loss from gambling, for instance, cannot be set off, even-in the same year, nagainst income from lotteries or other items of casual incomes. *The law does ot allow the carry-forward of losses attributable to the aforesaid sources of income except in the case of races including horse race.* Owners of race horses are entitled to carry forward and set off the loss incurred by them on maintenance of race horse against their income from the source 'races including horse races' in subseque nt year. The benefit of carry-forward in such cases will be allowed only for *four* assessment years next following the assessment year for which the loss was first computed.

Mr. Anand furnishes the following particulars of his income for the assessment year 1984-85

	Rs.
Income under the head Interest on Securities	25,000
Annual rental value of let out house property	18,000
Municipal tax paid	3,000
Net income from business A	18,000
Net income from business B	45,000
Loss from business C (before allowing depreciation)	21,000
Depreciation of business C	8,000
Gains on sale of a long-term capital asset	40,000
Loss on sale of a long-term capital asset	30,000
Loss on sale of a short-term capital asset	10,000
Dividends from P Co. Ltd.	Nil

Interest paid on moneys borrowed for purchasing of shares in P. Co. Ltd.			2,000
Loss on maintenance of race horses owned by him			20,000

Brought forward items from the earlier ass. years

Unrealised rent		12,000
Loss from business C relating to Assessment year	1974-75	30,000
-do-	1981-82	15,000
-do-	1982-83	25,000
Unabsorbed depreciation relating to business C		13,000

Compute Gross Total Income of Mr. Anand for the assessment year 1984-85 and indicate the entitlement of carry forward of losses unabsorbed if any.

Answer : Computation of Gross Total Income of Mr. Anand for Assessment Year 1984-85

			Rs.
Income under the head 'Interest on Securities'			25,000

Income under the head 'Income from House Property'

	Rs.		
Annual Rental value		18,000	
Less : Municipal taxes		3,000	
Annual Value		15,000	
Less : **Deductions under Sec. 24**			
Repairs 1/6th of Annual value	2,500		
Unrealised rent of earlier years	12,000	14, 00	
[assumed that the conditions laid down in Rule 4 are satisfied]			500
Income from House Property			

Income under the head 'Profits and Gains of Business or Professions

Net Income from business A	18,000	
Net Income from business B	45,000	
	63,000	

Less :		
Current Depreciation of business C as per Sa 32 (2)	8,000	
Unabsorbed loss of business relating to ass. year 1982-83 & 1981-82 as per sec. 72 [15,000+Rs. 25,000]	40,000	
Unabsorbed depreciation relating to business C under Sec. 32 (2)	13,000	**61,000**
		2,000
Less : Current Year's loss of business C		**21,000**
Loss under the head 'Profits and Gains of Business or Profession to be set-off against income computed under other heads.		**(—) 19,000**

Income under the head 'Capital Gains'

Gains on sale of long-term capital asset	40,000	
Less : Loss on sale of long-term capital asset as per Sec. 70 (2)	30,000	
Net long-term capital gain	10,000	
Less : Loss on sale of short-term capital asset [sec. 70]	10,000	

Income under the head 'Income from other Sources'

Dividends	Nil	
Interest paid on moneys forward for purchasing share (See note 2)	2,000	
Loss under the head Income from other Sources to be set-off against income under other heads of income under Sec. 71.		**—2,000**
Gross Total Income		**4,500**

Notes :

(1) Brought forward loss of business C relating to the **assessment year** 1974-75 cannot be set-off against income of this year as eight **assessment years have** lapsed since then upto the assessment year 1984-85.

(2) In view of the Supreme Court's decision in *CIT* v. ***Rajindra Prasad Moody*** *(1978) 111 ITR 159*, the interest on monies borrowed for **investment in shares is admissible as a deduction under Sec. 57 (iii) even though they have not yielded any dividend.**

(3) Loss from maintenance of race horses cannot be set-off against income from any other source under the same head or any other head of income. However, the loss can be carried forward for subsequent assessment years but not beyond 1988-89 as per Sec. 74A.

Part B

1. Total Income : Under Section 2 (45), total income means the total amount of income referred to in Section 5, computed in the manner laid down in the Act. We have already considered in Study Paper 2 the scope of total income under Section 5. The total income which is liable to tax is to be computed under various heads discussed in Study Papers 4, 5 and 6 in accordance with the principles explained therein. The provisions regarding set off losses, carry forward and set-off of business and capital losses shall also be given effect to. In computing the total income of an individual for the purpose of assessment, there shall also be included certain income of other persons. The circumstances under which income of other persons should be included in the assessee's total income are specified in Sections 60 to 65. Let us consider these provisions briefly.

2. Income of other Persons included in the Assessee's Total Income (Sections 60 to 65).

The provisions contained in Sections 60 to 65 have been designed to overtake and circumvent a growing tendency on the part of taxpayers to endeavour to avoid or reduce their tax liability by means of transfer and settlements of their assets or income or both. These provisions have been included in the Act with a view to preventing evasion of tax by assessee by transferring assets or income in favour of any person, and more particularly in favour of spouse, children and certain other relatives. These Sections cover all transfers including those effected prior to the commencement of the Act.

2.1 Transfer of income without Transfer of Assets (Section 60) : Under this Section all income arising to any person by virtue of any transfer as settlement, trust, covenant, agreement or arrangement from assets which remain as the property of the person who effected the transfer, settlement, *etc.*, is deemed to be the income of the transferer without any exception and consequently would be taxable in his hands. For this purpose it is immaterial whether :

(i) the transfer is revocable or irrevocable ;

(ii) the transfer is made in favour of a relative or non relative.

(iii) the transfer is made before or after the commencement of the Act.

Thus, this section applies to all cases of transfer of income without transfer of the assets yielding the income. The purpose of application of income under the deed of transfer, settlement, trust, *etc.*, is immaterial for consideration in this regard.

2.2 Revocable Transfer of Assets and Transfer Irrevocable for a specified Period (Sections 61, 62 and 63) : All income arising to any person by virtue of a transfer of assets under a settlement, trust, arrangement or otherwise is deemed to be the income of the transferer if any one of the following conditions is satisfied.

(a) if the transfer is revocable ;

(b) if the deed of transfer contains any provision for the direct or indirect transfer to the whole or part of the income or assets to the transferor ;

(c) if it in any way, gives the transferor a right to reassume power directly or indirectly over the whole or any part of income or assets transferred.

Exception (Section 62) : There is however, one exception to this provision ; in other words the provisions of Section 61 will not apply to a transfer which satisfies *all* the following conditions.

1. The transfer is irrevocable (i) in the case of a trust during the lifetime of the beneficiary or (ii) in the case of any transfer during the life-time of the transferee, or (iii) in the case of a transfer made before 1-4-1961 for a period of at least six years.

2. The deed of transfer does not contain any provision for the direct or indirect transfer of the whole or any part of income or assets to the transferor during the period specified in (1) above.

3. The transfer does not in any way give the transferor a right to reassume power, directly or indirectly, over the whole or any part of the income or assets during the aforesaid period

4. The transferor does not derive any direct or indirect benefit from the income or the assets.

The provisions of this Section (*i.e.* Section 61) can be invoked only if the transfer is coupled with either the power of revocation or the non-compliance with the conditions given (in the exception) above and for this purpose it is immaterial whether the power of revocation is actually exercised or not.

The provisions of the Section 61 merely shift the liability to tax from the beneficiary to the settler ; it does not either charge the character of the income or bring to charge any item of income which is exempt from tax under any other provision of the Act. Where the income in question is partly exmpt and partly taxable the liability under this Section would arise only in respect of that part of the income which is taxable.

Thus, in all cases where the transfer is (i) revocable, or (ii) the transferor gets any direct or indirect benefit from the trust; or (iii) a right to reassume power is exercisable by the settler, income from the assets will be included in the transferor's total income and taxable in his hands. For this purpose 'transfer' includes any settlement, trust, covenant, agreement or arrangement. The provisions of Sections 60 to 63 apply to all assessees including companies.

2.3. Income of the spouse, minor child etc., to be included in the Assessee's total Income [Section 64 (1)] : This Section is intended to foil the attempts of an *individual* to avoid or reduce the incidence of tax by transferring assets to his spouse or minor child or admitting the spouse as a partner or admitting the minor child to the benefits of a partnership or by transfer of assets to certain other specified relatives.

In computing the total income of any individual, the following income will also be included.

(1) **All income which arises directly or indirectly to the** *sponse* **of such individual from the membership** of the sponse in a firm carrying on a *business in which individual is a partner*—Section 64 (1)(i) In the case of a *professional* firm, where both the husband and wife are partners, each of them would be assessed separately in respect of hisor her share of the firm's income.

Where both the husband and the wife are partners in the same firm, for purposes of the aggregation of the income from partnership, under Section 64 (1) the income of the spouse must be added to that of the husband or wife whose total income (excluding the income from the firm), is greater. This is made clear in Explanation 1 to Section 64 (1).

By virtue of Explanation 1A to sub-section (1) of Section 64, where the spouse of an individual is a beneficiary under a trust and the trustee joins in any partnership business with individual, the income arising from such partnership to the trust to the extent it is for the benefit of the spouse. will be included in the total income of the individual.

(2) All income which arises directly or indirectly to the *spouse* by way of salary, commission, fees or other form of remuneration in cash or in kind from a concern in which such individual has substantial interest [Section 64 (1) (ii)]. Explanation 1 to Section 64 (1) makes it clear the income arising to the spouse by way of salary, commission, fees or any other form of remuneration from a concern in which both the individual and the spouse have substantial interest will be included in the total income of the individual or spouse whose total income excluding such salary, commission, *etc.*, is greater.

This provision, however. will not be applicable to the income of the spouse of an individual, earned by virtue of technical or professional qualifications and which is solely attributable of the application of such technical or professional knowledge and experience, from a concern in which such individual has a substantial interest. For this purpose, an individual shall be deemed to have a substantial interest in a concern—

(i) in case where the concern is a *company*, if its shares (not being shares entitled to fixed rate of dividend whether with or without a further right to a participate in profits)—*i.e.* equity shares—carrying not less than 20 per cent of the voting power at any time during the previous year, owned beneficially by such person or partly by such person *and* partly by one or more of his relatives ;

(ii) in any other case, if such person is entitled or such person *and* one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern.

Again, for the purpose of this provision, the term 'relative' is defined in Section 2 (41) so as to cover the husband wife, brother or sister, any lineal ascendant or descendant of an individual :

(3) **All income arising to the *minor child* of the individual from the admission of the minor to the benefits of partnership firm—Section 64 (1) (iii)** – is to be noted that according to this provision, the income of the minor child arising from admission to the benefits of partnership in all cases will be included in the income of the parent who *has the* higher *income.* In other words, this clubbing will take place *even though neither of the parents is a partner in the firm.*

The share income of the minor child should be included in the total income of that parent whose total income (excluding the income of the minor child from the firm under Section 64 (1) *(iii), is greater than that of the other.* Even where the minor child has an income in his or her own right other than the share income from the firm, the share of income from the firm must be added to that of one of the parents whose income is greater, Still further where any such income has once been added to the total income of the spouse or parent in any previous year the same practice should be followed in the subsequent year also, though it can be altered later on by the Income-tax Officer if he finds that such a change is necessary after giving the other spouse or the parent a reasonable opportunity of being heard. This is made clear in Explanation 1 to Section 64 (1).

By virtue of the Explanation 2A Section 64(1) where the minor child of an individual is a beneficiary under a trust and the trustee joins in any partnership business with any person the income arising from such partnership to the trust, to the extent it is for the benefit of the minor child, will be included in the total income of the individual.

The provision stated above in regard to the treatment of income of the spouse or minor child from a firm are absolute and unqualified having no exception. The fact that the spouse or minor child is only a dormant partner or a partner only by name does not affect the liability to tax under this Section. However, if one of the spouses is only an employee or agent of the firm or if one of the spouses or the minor child receives the income from the firm by virtue of any other contract with the firm (*e g* , interest, royalties, fees or commission) the provisions of this Section 64 (1) (i) (iii) canpot be invoked so as to include the income of the recipient in the total income of the spouse or parent.

Where the child admitted to the benefits of partnership is not a minor or is only an illegitimate child of the individual or then the income arising to the minor child shall not be included in the total income of the individual. However, where a minor married female child is admitted to the benefits of a firm in which both her father and her husband are partners, her share of the firm's income shall be included in her father's (and not husband's) total income. The provisions of this Section would be attracted (a) whether or not assessee's spouse or minor child is allowed a share in the firm without any contribution on their part to the capital or assets of the firm ; or (b) whether they become members of the firm in their own right or in a representative capacity.

(4) All income, other than income falling under (1) above which arises directly, or indirectly to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart—Section 64 (1) (iv). This is, however, subject to the provisions of Sections 27 (i) governing house property transferred to the spouse.

(5) All income, other than income falling under (3) above, which arises to the minor child (not being a married daughter) of such individual from assets transferred, directly or indirectly, to the minor child by such individual—Section 64 (1) (v). This is also subject to the provisions of Section 27 (1) governing house property transferred to the minor child.

Where the asset transferred in a house property the income from which is chargeable to tax under Section 22 and the transfer is made (i) to a spouse otherwise than for adequate consideration or in connection with an agreement to live apart or (ii) to minor (not being a married daughter) without adequate consideration, the transferor is deemed under Section 27 (i) to be the owner of the property and is assessable accordingly in respect of the income from the property. However, where the wife constructs a house out of money gifted by her husband the income from the house property assessable in the hands of the husband is to be computed on the basis of the wife being the owner, and consequently if she resides in the house the limits prescribed for restricting the annual value of the house under Section 23 (2) should be determined on the basis of her total income The income arising from the assets transferred would be included in the total income of the transferor irrespective of the fact whether the income is derived from the asset in the original form in which it was transferred or in a different form.

The Explanation 3 to Section 64 (1) provides that if the spouse or minor child to whom the assets are transferred by the individual has invested the same or a part thereof in any business, the proportionate income of such business attributable to such investment will be clubbed with the income of the individual. The effect of this Explanation is that the income from investment of transferred assets need not arise from approximate source for the purpose of clubbing the income. To this extent this provision negatives the effect to the decision of the Supreme Court in the case of *C.I.T. vs. Premhhai Parekh and Others 71 I.T R. 27 (S C.)* For the purpose of finding out the proportionate income the total value of the assets transferred to the spouse or minor child will be compared with the investment by such spouse or minor child in the said business as on the first day of the accounting year. The proportionate income from the business will be considered as having arisen from the assets transferred by the individual. Thus, if a person has given a gift of Rs. 1 lac to his wife and she has invested this amount in any business carried on by her the entire income of the business will be clubbed with the income of the husband. If in this case the wife has her personal funds and besides the above investment of Rs. 1 lac she has also invested a further amount of Rs. 1 lac from her own resources in the above business and the position on the first day of the previous year shows that her total investment in the business is of Rs. 2 lac which includes the amount of Rs 1 lac received from her husband by way of gift then only 50% of her income from business will be clubbed with the income of the husband. It is to be noted that the provision is applicable only if the investment is made in any *business*.

(6) All income which arise to the son's wife (daughter-in-law) or son's minor child (grand child) of the individual from assets transferred by the individual directly or indirectly *on or after 1st June*, 1973, otherwise than for adequate consideration—Section 64 (1) (vi) This is a new area of clubbing applicable to transfers effected on or after 1st June, 1973.

It is significant to note that the above provisions do not apply to a trust created for the benefit of a son's wife or a son's minor children. Thus the income of trust created for the benefit of daughter-in-law or grand children will not be clubbed with the income of the settlor Similarly, the above provisions do not apply to transfer of assets to son-in-law or to the minor children of daughter. Gift made to a lady before she marries the son of an assessee or to a child before his adoption by the son of the assessee will also be outside the scope of these provisions. It is to be noted that this provision would also cover cases of transfers to son's minor married daughter.

(7) All income which arises directly or indirectly to any person or association of persons from assets transferred *directly or indirectly* otherwise than for adequate consideration to the person or association of of persons by such individual, *to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse or minor child not being a married daughter or both*—Section 64 (1) (vii).

It is significant to note that the Explanation 3 to Section 64 (1) does not extend to income arising from transfer of assets to daughter in law and grand children covered by Section 64 (1) (vi) and to income of trusts created for the benefit of spouse and minor children under Section 64 (i) (vii). Therefore, if the assets gifted to daughter in-law or grand children are invested by them in any business, income derived from such business will not be treated as income from such transferred assets and the principle laid down by the Supreme Court in the case of *Premibhai Parekh's* case in 77 I T.R. 77 will hold in respect of transfers under Section 64 (1) (vi).

In cases where the income is included in the income of another person under the provisions of Section 64(1), the income flowing out of the investment of such included income will not be so clubbed. Similarly, the clubbing provisions will not cover income arising from accretions to the assets transferred. The amount to be included in the total income of the transferor should be either the income arising directly or indirectly from the assets transferred or capital gains arising from the transfer but not the income arising from the accumulated income or from accretions to the assets transferred Thus, if an individual transfers shares to his minor son, bonus shares received by the son in respect of his shareholding would not be asset transferred by the individual to his son but would constitute *accretions* to the asset transferred and consequently the dividend on the bonus shares cannot be included in the total income of the father. The income includible in the total income of the transfer is only the income actually arising from the assets transferred but not the income which may be deemed to accrue or arise under any provision of the Act. For purposes of applying this Section the relationship between the transferor, and the transferee, in case of transfer to the spouse, should be legally that of a husband and wife not only at the time of accrual of income but also at the time of transfer. Thus prenuptial transfer will not come within the purview of this provision. Where the transfer is to a minor child the provisions of this Section would apply irrespective of the fact whether the transfer is made for the immediate or deferred benefit of the minor. But if the income during minority is to be accumulated and added to the corpus and the income therefrom is to be given to the minor on his

attaining majority, the income so accumulated or given to the minor cannot be included in the income of the parent. This Section would not also apply after the minor child attains majority or if the minor child who is a female gets married.

Thus, a transfer, in order not to attract this section, should be made not merely for good consideration but necessarily for adequate consideration. It is worthwhile to note that natural love and affection will not constitute adequate consideration and as such transfers made on consideration of love and affection would still be covered by this Section. The benami, incomplete or illegal nature of the transfer or the income would not, in any way, affect the liability of the transferor under this Section,

2.4 **Cross Transfers** : In the case of cross transfers also (*e.g.* A making a gift of Rs. 50,000 to the wife of his brother B for the purchase of a house by her and a simultaneous gift by B to A's minor son of shares worth Rs. 50,000 owned by him) the income from the assets transferred would be passed in the hands of the transferor even if (i) the transfers are so intimately connected as to form part of a single transaction ; and (ii) each transfer constitutes consideration for the other by being mutual or otherwise. Thus, in the instant case the transfers have been made directly by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this Section, showing that each transfer constitutes consideration for the other. The Supreme Court in the case of *C.I.T. v. Keshavji and Morarji and another (1967) 66 I.T.R. 142* held on similar circumstances that cross transfers are of an indirect nature would thus be brought under this Section. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B (and not A) and the dividends from shares transferred to A's minor son would be taxable in the hands of A (but not B). This is because A and B become the indirect transferors to their minor child and spouse, respectively of the assets yielding various amounts of income so as to reduce the burden of taxation.

2.5 Conversion of self-acquired Property into the Property of a Hindu Undivided Family [(Section 64 (2)]—Section 64 (2) deals with case of conversion of self-acquired property into property of a Hindu undivided family. The provisions of Section 64 (2) as amended up-to-date are summarised below :

(1) Where an individual converts at any time *after 31-12-1969*, his separare property into property belonging to the Hindu undivided family of which he is a member by impressing such property with the character of the property belonging to the family or by throwing such property into the common stock of the family or by transferring such separate property, directly or indirectly to the family otherwise than for adequate consideration, the individual *shall be deemed to have transferred* such property to the members of the family for being held by them jointly. This provision will apply in all such cases notwithstanding anything contained in any other provision of the Income-tax Act or any other law for the time being in force.

2. In computing the total income of such an individual, the entire income from such converted property shall be included.

3. Where the converted property has been partitioned either by way of total or partial partition the income derived from such converted property as is received by the spouse or minor child on partition will be deemed to arise to the *spouse or minor child* from assets transferred indirectly by the individual to *spouse or minor child* and consequently such income shall also be included in the income of such individual.

4. Where income from the converted property is included in the total income of an individual under Section 64 (2) it will be excluded from the total income of the family or as the case may be of the spouse or minor son of the individual. That part of the income from the converted property which is not includible in the total income of the individual who effected the conversion should be taxed as the income of the H.U.F.

It must be noted that the above provisions will be applicable in all cases irrespective of the fact whether or not the Income-tax Officer is of the opinion that this will result in a benefit to the Revenue Explanation to Section 64 (2) provides that for the purposes of this provision the term 'property' includes any interest in property (movable or immovable), the proceeds of the sale of such property and any money or investment which for the time being represents such sale proceeds and also any property converted from one *species* into any other property by any method.

Income for the Purposes of Section 64 (1) Includes Loss : It is significant to note that as per the Explanation 2 to Section 64, effective from 1st April, 1980, for the purposes of Section 64 "income" would include 'loss' Accordingly, where the specified income to be included in the total iucome of the individual is a loss such loss will be taken into account while computing the total income of the individual. It is significant to note that this Explanation applies to the provisions of both such section (1) and sub-section (2) of Section 64.

The provisions contained in Sections 61 to 64 as discussed above are not mutually exclusive. In this connection it may be noted that the main distinction between the two sections is that Section 61 applies only to revocable transfer made by a class of assessee while Section 64 applies to revocable as well as irrevocable transfers made only by individual.

There seems to be a conflict of judicial opinion regarding the head under which income includible under Sections 60 to 64 is to be assessed. According to one view the included income retains the same head under which it is earned. The decision of the Mysore High Court in *J.H. Golin* v. *C.I.T. (1963) 91 I.T.R. 631* supports this view. On the other hand the Bombay High Court's decision in *Keval Chand Mehta* v. *C.I.T. (1968) 67 I.T.R. 804* supports the view that the included income is always to be treated under the head "income from other sources". It is submitted that the view of the Mysore High Court appears to be more rational.

DEDUCTIONS FROM GROSS TOTAL INCOME

(Students may note that in the following pages the deductions available to *all* the tax-payers are discussed. A separate classification of these deductions as applicable to different categories of tax-payers can be found in the following pages).

Chapter VIA of the Income-tax Act, 1961 deals with the various deductions that are admissible from the gross total income of an assessee in the computation of total income.

General Provisions : Section 80A (i) provides that in computing the total income of an assessee, there shall be allowed from his gross total income the deductions specified in sections 80C to 80VV.

According to section 80A(2) the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee. Thus an assessee cannot compute a minus figure i.e. a loss as a result of the deductions under chapter VIA and claim to carry forward the same for the purpose of set-off against his income in the subsequent year. The only exception to this rule is the carry forward of the unabsorbed portion of the tax-holiday benefit i.e. the "deficiency" under section 80 J(3). Consequent to the introduction of the provisions of Section 80I, even this exception has got only limited applicability now.

Section 80A(3) provides that where a deduction is admissible under Chapter VI-A in computing the total income of a firm, association of persons or body of individuals, no deduction under the same section shall be allowed in computing the total income of a partner of the firm or a member of the association or body, in relation to his share in the income of the firm, association or body. This is to prevent duplication of deductions.

(i) **Insertion of Section 80AA** : *In Cloth Traders Pvt. Ltd.* v. *Additional C. I. T. (1979 118 I. T. R. 243,* the Supreme Court has held that the deduction admissible in respect of inter corporate dividends has to be calculated with reference to the gross amount of dividend received by a domestic company from an Indian company and not with reference to the dividend as computed in accordance with the provisions of the Income-tax Act i.e. after making deduction provided under the Act in respect of items like interest paid on borrowings utilised for the purchase of shares, etc. Since the Government's intention has always been to grant the deduction at the specified percentage on the *net* income of such dividend and *net* on the *gross* amount of such dividend, the Finance (No. 2) Act, 1980 has inserted a new Section 80AA with *retrospective effect* from 1st April, 1968, i.e., the date of insertion of Chapter VIA of the Income-tax Act. The new Section provides that deduction under Section 80M in respect of inter-corporate dividend will be calculated with reference to the dividend income as computed in accordance with the provisions of the Income-tax Act and *not* with reference to the *gross* amount of such dividend as a result of this amendment with effect from the assessment year 1968-69 and the subsequent years, the deduction will be calculated with reference to net amount of such income.

In order to preserve the sanctity of the ruling of the Supreme Court, the Finance Act has made a saving provision to provide that the new provisions of

Section 80AA will not apply to the assessment of an assessee for a particular assessment year, where the Supreme Court has, on appeal or reference in respect of the assessment of the assessee for that year; held before 18th June, 1980 i e., on the date on which the Finance (No. 2) Bill 1980 was introduced in the Parliament that the deduction in respect of inter-corporate dividend should be allowed with reference to the particular year of assessment for which the Supreme Court has given a judgement adverse to the revenue on an appeal or reference made to the Court The saving provision will not, therefore, apply in relation to cases whether neither *the assessee nor the revenue had gone up in appeal or reference to the Supreme Court.*

(ii) **Insertion of Section 80AB :** Though the Supreme Court decision in *Cloth Traders Case* concerned mainly with the deduction in respect of inter corporated dividend, the Court in the course of its judgement has specifically referred to some of the other Sections contained in Chapter VIA of the Income tax Act and observed that on a plain reading of the Sections, the deduction is admissible in respect of the gross amount of income received by an assessee and not in respect of the net income computed after making the deductions provided in the Income-tax Act. In order to the remove any possible doubt in this matter, a new Section 80AB has been inserted in the Income-tax Act to provide that for the purpose of calculation of the deduction specified in Sections 80HH to 80TT, the net income computed in accordance with the provisions of Income-tax Act (before making any deductions under Chapter VIA) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid Sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deductions under Chapter VIA) and not with reference to the *gross* amount of such income subject, however, to the requirements of the respective Sections.

The new Section 80AB is effective from Ist April 1980 and will accordingly apply in relation to the assessment year 1981-82 and subsequent years. It is to be noted that unlike Section 80AA, the provisions of Section 80AB will not have any retrospective operation.

There are certain definitions given in section 80B. Accordingly "gross total income" for the purposes of Chapter VI-A means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A and/or under section 280-0. "Computed in accordance with the provisions of the Act" implies—

(1) that deductions under appropriate computation sections have already been given effect to,

(2) that income of other persons, if includible under sections 60 to 64 has been included.

(3) that intra-head and or inter-head losses have been adjusted and

(4) that unabsorbed business losses etc. unabsorbed depreciation, unabsorbed investment allowance etc. have been set off.

The deductions allowable under Chapter VIA can be classified into two categories.

1. *Deductions in respect of Payments.*
80C, 80CC, 80D, 80E, 80F, 80G, 80GG, 80GGA, 80V, 80VV

2. *Deductions in respect of Incomes.*
80HH, 80HHA, 80HHB, 80HHC 80I, 80J, 80JJ, 80K, 80L, 80M, 80MM, 80N, 80O-, 80P, 80QQ, 80QQA, 80R, 80RR, 80RRA, 80S, 80T, 80TT, 80U.

A further classification can also be made on the basis of their applicability as follows :

I. **Deductions applicable to Individuals only**
Sections 80E, 80F, 80GG. 80QQA, 80R, 80RR, 80RRA, 80U.

II. **Deductions applicable to Individuals and HUFs**
Section 80D.

III. **Deductions applicable to Individual, Hindu Undivided Families and specified association of persons**
Sections 80C, 80CC, 80L.

IV. **Deductions applicable to all non-corporate assessee**
Sections 80-S, 80-T, 80TT.

V. **Deductions applicable only to Corporate assessees**
Sections 80M (Domestic Company), 80MM (Indian Company), 80N (Indian Company), 80-O (Indian Company).

VI. **Deductions applicable to all assessees**
Sections 80G, 80GGA, 80HH, 80HHA, 80I, 80J, 80JJ, 80JJA, 80K 80QQ, 80V, 80VV.

VII. **Deductions applicable to Indian Companies and other resident non-corporate assessees**
Sections 80HHB, 80HHC.

VIII. **Deduction applicable to co-operative societies**
Section 80P.

Let us first consider the deductions allowable in respect of certain payments.

1. **Life Insurance Premia, contribution to provident funds etc. (Section 80C)**

The classes of assessees to whom the provisions of section 80C apply are—

(i) individuals

(ii) Hindu undivided families

(iii) association of persons in certain Union Territories such associations consisting of husband and wife.

The scheme of section 80C is that if the assessee pay any life insurance premium etc. during the previous year *out of his income chargeable to tax*, he becomes entitled to a deduction from his gross total income of an amount equal to the aggregate of :

For Assessment years 1981-82 and 1982-83

100% of the first Rs. 5,000	of the qualifying amount
50% of the next Rs. 5,000	
40% of the remainder	

For Assessment year 1983-84 (Amendment made by Finance Act, 1982 (14 of 1982).

100% of the first Rs. 6,000	of the qualifying amount
50% of the next Rs. 6,000	
40% of the remainder	

In order to get the benefit, the sums must have been paid (1) by the assessee (2) out of his income chargeable to tax. Coming to the question of payments being made out of incomes chargeable to tax, there is no difficulty so far as deductions at source are concerned. But in other cases the assessee has to demonstrate that such payments flowed out of his chargeable income. Thus, if a non-resident person pays life insurance premium out of his foreign income net includible in his total income no deduction will be available to him in respect of such premium.

In C.I.T. Chellaiah 147 I.T.R. 590 (Madras) the interest earned by the assessee's wife on the amounts gifted by the assessee was included in the total income of the assessee by virtue of section 64(1)(iv). Premia in respect of the policy of his wife was paid out of her interest income. The question arose as to whether the premium so paid would be deductible under section 80C in computing the income of assessee. It was held that even though the interest income earned by the assessee's wife was included in the assessee's total income as per section 64(1)(vi), it was to be treated as gross total income of the assessee as contemplated under section 80A(1). Hence, the assessee would be entitled to relief under section 80C in respect of the premium paid on the policy taken out of interest earned by his wife.

The various items of payment in respect of which a deduction is allowable under this section are stated below :

A. *In the case of individual*

(1) Premium paid on insurance on the life of the assessee and/or his or her spouse or child (minor or major).

(2) Premiums paid to effect or keep in force a contract for a deferred annuity on the life of the assessee and/or of his or her spouse or child, provided such contract does not contain any provision for the exercise by the insured of an option to receive a cash payment in lieu of the payment of the annuity.

In the above two cases the qualifying amount of premium in respect of any particular policy shall not exceed 10% of the actual capital sum assured. However, if the premium paid is in excess of 10% of the capital sum assured, the amount of premium paid in excess of 10% shall not qualify for the deduction. For this purpose while calculating the capital sum assured no account shall be taken of the value of any premium returnable or any benefit by way of bonus receivable by the insured over and above the capital sum assured on the policy.

It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be earned into with any person.

In the case of an individual the insurance on his life will include a policy of insurance securing the payment of a specified sum on the stipulated date of maturity if such person is alive on such date, even if the policy provides only for the return of premiums paid with or without interest thereon in the event of his dying before the said stipulated date. The insurance shall also include a policy effected by a person for the benefit of a minor, with the object of enabling such minor after he has attained majority, to secure an insurance on his own life by adopting the policy and on his being alive on a date after the adoption, specified in the policy in this behalf.

C.B.D.T. Circulars : (a) The relief under section 80C is available to contributions made under the Central Government employee's Insurance Scheme (Circular No. 233 dated 5.12.77).

(b) The contributions made by employees to the Family Pension Fund established by a scheme under the Employees Provident Fund and Family Pension Fund Act, 1952 would also qualify for deduction under section 80(c) (2) (a) (ii). (Circular No. 194 dated 25th March 1976).

(3) Contributions to any Provident Fund to which Provident Fund Act, 1925 applies. In this case the entire amount contributed by the assessee shall qualify for deduction subject to the over-all limit.

(4) Contributions made to any provident fund set up by the Central government and notified in this behalf (i.e. the Public Provident Fund Act, 1968).

(5) Contribution to a recognised provident fund of which he is a member. The excess, if any, over 1/5th of the salary or over Rs. 10,000 whichever is less is to be ignored. 'Salary' here includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. It may be noted here that the limitations of one-fifth of salary or Rs. 10,000 as the case may be, do not apply to contributions to a Provident Fund to which the P.F. Act, 1925 applies.

(6) Amount deducted by or on behalf of the Government, from the salary of a Government employee for securing a deferred annuity or making provisions for his wife or children. The excess, if any, over one-fifth of the salary is to be ignored. The overall limit applies.

(7) Assessee's own contribution to an approved superannuation fund of which he is a member. The entire contribution subject to the over-all limit, qualifies for the deduction.

(8) Deposits in a 10 year or 15 year account under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959. Subject to the over-all limit the entire amount deposited qualifies for the deduction.

(9) Contributions for participation in the Unit-linked Insurance Plan, 1971. The entire amount subject to the over-all limit, qualifies for the deduction. However, section 80C(5) provides that if an assessee terminates his participation before the

contributions in respect of the participation have been paid for 5 years, then no deduction is to be allowed for the contributions for the year of termination and moreover, the deductions, if any, allowed for the preceding previous year shall be deemed to be income of the year of termination and charged to tax accordingly.

2. In the case of Hindu Undivided Families :

There is only one item here viz. the sum paid to effect or keep in force an insurance on the life of any member of the family. Here also the limitation of 10% of the capital sum assured applies. As already noted in the case of an individual, the amount qualifying for deduction would include also the premium on the policy of a minor (male or female) of the family with the object of enabling the minor, on his/her attaining majority, to secure an insurance on his own life by adopting the policy.

Amendment by the Finance Act 1983 : The Finance Act 1983, has provided that with effect from 1 4.84 (assessment year 1984-85). H.U.Fs would be entitled to deduction under this provision, in respect of the following categories of long-term savings also.

(i) Contribution to a public provident fund in an account standing in the name of any member of the family.

(ii) Deposits made in a 10 year of 15 year account standing in the name of any member of the family under the Post Office Savings Bank (Cumulative Time Deposits) Rules 1959.

3. In the cases of certain association of persons :

The benefit described above is available also to an assessee being an association of persons or a body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu.

The items for which the benefit is available, overall limits etc. are the same as in the case of individuals described above.

Policy Terminated before 2 years premiums paid : [80 (c) (b)] Where an individual, Hindu Undivided family or married couple governed by the system of community of property in specified Union Territories has effected or kept in force any insurance on the life of the specified persons and such assessee terminates the contract of insurance by notice to this effect or where the contract ceases to be in force as a result of failure to pay any premium by not reviving the contract of insurance before premiums have been paid for a period of two years, no deduction under section 80C shall be allowed to the assessee in respect of such premiums paid in the previous year in which the policy is terminated. Further any deduction allowed in respect of premium or premiums paid in the immediately preceding previous year or years shall be deemed to be the income of the assessee of such previous year or years and shall be charged to tax accordingly.

Explanation 1 to section 80C(b) provides that the deduction allowed under section 80C in respect of any premiums paid in any previous year shall be the amount by which the actual deduction allowed under that section for that year exceeds the amount of deduction which would have been allowed for that year if no such premiums had been so paid.

Explanation 2 to section 80C(b) provides that where an assessee terminates his participation in the unit-linked insurance plan and also a contract of insurance in the same previous year, the deduction allowed under section 80C in respect of such contribution or premiums paid for the previous year shall be the amount which the deduction allowed under section 80 for that year exceeds the amount of deduction which would have been allowed for that year if no contributions of premium had been paid during the year.

The Finance Act, 1982, has also empowered the CBDT, under Section 80C (2) (h), to notify any security, the subscription to which by *all the above three categories of assessee* will qualify for deduction. In exercise of this power, the CBDT has notified National Savings Certificates VI and VII issues for this purpose.

Overall limits ; The aggregate of the sums which qualifies for the purposes of computing the deduction shall not exceed the following limits :

(i) For an individual who is an author, playwright, artist, musician, actor or sportsman including an athlete the CBDT has prescribed the maximum overall limits in Rule 11A The qualifying amount by reference to which the deduction is to be computed, shall not exceed the lower of the following two amounts—

(i) an amount equal to the aggregate of 40% of the income from such profession included in his gross total income and 30% of the remaining part of the gross total income or

(ii) a sum of Rs. 60,000 whichever is less.

2. For any other individual to whom paragraph (a) does not apply, a HUF or an association of persons as mentioned above, the overall limit is 30% of the gross total income subject to the maximum of

Rs. 30,000 upto 1982-83 assessment year.

Rs. 40,000 from 1983-84 assessment year.

Amendments by Finance Act, 1983 : The Finance Act, 1983 has abolished the ceiling by way of percentage of the gross total income, while determining the qualifying amount of savings, with effect from 1st April 1984 (Assessment year 1984-85). Consequently the qualifying amount would be subject to only monetary ceilings viz Rs. 60,000 or Rs. 40,000 as the case may be.

2. **Deduction in respect of investment in certain new shares** : (80CC) Section 80CC has been inserted with a view to give some inducement to tax-payers so that they may acquire shares in new industrial companies. The benefit is by way of a deduction from the gross total income of a sum equal to 50% of the cost acquisition of the shares forming part of the eligible issue of capital. The benefit is available to assessees of the following categories :

(a) individuals

(b) Hindu Undivided Families

(c) association of persons or a body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union territories of Dadar and Nager Haveli and Goa, Daman and Diu.

Conditions : 1. The assessee must acquire the equity shares forming part of an eligible issue of capital during the previous year out of his income chargeable to tax.

2. The maximum amount of investment qualifying for the deduction is Rs. 20,000.

3. Where the full payment of the money required for the investment has not been made in the previous year in which the acquisition takes place, but the unpaid portion is paid within the six months' period immediately succeeding the said previous year, the amount so paid will also be treated as paid in that earlier previous year itself.

4. Where the aggregate cost to the assessee of the shares acquired as above exceeds Rs 20,000 the deduction will be allowed with reference to such of those shares the aggregate cost whereof to the assessee does not exceed Rs. 20,000 as are specified by him in this behalf

5 The assessee should have subscribed to the shares in pursuance of an offer for subscription to the public made by the company or in pursuance of a reservation or an option made in his favour by reason of his being a promoter of the company.

6. Alternative to the above, the assessee should have purchased the shares from a person who is specified as an underwriter in respect of the issue of such shares, in pursuance of the relevant provisions of the Companies Act and who has acquired such shares by virtue of his obligation as the under-writer for the issue.

7. Where an assessee has obtained the deduction in respect of any shares under section 80CC he loses that benefit if he disposes of those shares at any time within five years from the date of their acquisition. An amount equal to 50 per cent of the cost to the assessee of the shares so sold must be deemed to be the income of the assessee in respect of the previous year in which the shares were sold. Such income would have the character of income from other sources. For this purpose an assessee shall be regarded as having acquired any shares on the date on which his name is entered in relation to those shares in the register of members of the company.

Eligible issue of capital

For this purpose the expression "eligible issue of capital" means issue of equity shares which satisfies the following conditions --

(i) The issue is made by a public company formed and registered in India with the main object of carrying on the business of (a) construction, manufacture or production of any article or thing other than an article or thing listed in the Eleventh Schedule to the Income-tax Act or (b) providing long term finance for construction or purchase of houses in India for residential purposes.

(ii) The issue is an issue of capital made by the company for the first time.

(iii) The shares forming part of the issue are offered for subscription to the public.

(iv) Such other conditions as may be prescribed by the Central Board of Direct Taxes should also be fulfilled.

In the case of a public company formed and registered in India, with the main object of carrying on the business of providng long-term finance for construction

tion or purchase of house in India for residential purposes, in order to entitle the investor shareholder to claim the tax benefit under this Section it is also essential that the company must be approved by the Central Government for this purpose

In cases where a company was originally incorporated as a private company but it has subsequently become a public company under the provisions of the Companies Act, an issue of shares made by it for the first time after it has become a public company would not be regarded as an eligible issue of capital if (i) such company had declared, distributed or paid any dividend when it was a private company ; or (ii) any of the shares forming part of the issue is offered for subscription at a premium. Wherever any question arises as to whether any issue of equity shares would constitute an eligible issue of capital for purposes of this deduction the question should be referred to the Central Government whose decision thereon shall be final. In this context, the expression 'company' must be taken to have the same meaning as is assigned to it under Section 3 of the Companies Act, 1956.

By virtue of an amendment made by the Finance Act 1984 no deduction will be available with reference to the cost of any shares offered for public subscription after 31.3.1987.

Expenditure on medical treatment of handicapped dependents (80D)

The Finance Act. 1981 has liberalised the scope of this provision.

(1) Individual and Hindu Undivided families resident in India.
(2) Incurring any expenditure on the medical treatment (including nursing) of a 'handicapped dependent'.
(3) Out of their income chargeable to tax deduction are entitled to a specified.

Handicapped dependent :

In the case of an individual any one of his relatives as defined in section 80B(8) and, in the case of a Hindu undivided family any member of the family, who is exclusively dependent on the individual or family as the case may be for his support and maintenance and who is suffering from a physical or mental disability which is certified by a medical practitioner to have the effect of reducing considerably such person's capacity for normal work or engaging in a gainful employment.

Limit of deduction ·

(1) If the handicapped dependent has been treated for 182 days or more during the previous year in an approved institution—being a hospital or nursing home or other institution—a sum of Rs. 4800 will be allowed as a deduction from the gross total income.

(2) In any other case—a sum of Rs. 1200 will be allowed as deduction.

Students may note that the actual amount of expenditure incurred may be even less than the specified deduction.

By virtue of an amendment made by the Finance Act, 1984 the deduction under section 80D will not be available for the assessment year 1985-86 and onwards.

Deduction in respect of Payments for Securing Retirement Annuities : (80E)

The benefit of this deduction is available only to individual who are citizens of India and residents in India and are partners in a registered firm rendering professional service as chartered accountants. solicitors, lawyers, architects or experts in other approved professional services. The deduction is allowable in respect of :

Rs

(a) any premium paid under an approved annuity contract with the main object of providing for a life annuity for the individual commencing between the [illegible] or for the individual's widow or widower;

(b) any premium paid to an approved annuity fund. The premium so paid is to be deducted from the assessee's gross total income but the allowance shall not exceed the income arising under the head 'profits and gains of business or profession'. Further, the amount of deduction shall not exceed Rs. 5,000 or 10% of the gross total income or the amount of premium actually paid, whichever is the least.

But if the assessee has a total income which includes unearned income exceeding Rs 10,000 or is entitled to any pension or participates in any pension or superannuation fund, he cannot claim this deduction. 'Unearned income' here means income chargeable under the head 'Interest on securities' or Income from house property' or 'Capital gains' or any income chargeable under the head 'Income from other sources' in so far as it is not immediately derived from personal exertion of the individual. The section also specifies the conditions that must be satisfied, before the contract of annuity and annuity fund can be approved by the commissioner

Further, if the individual himself is the recipient of the annuity it is deemed to be his earned income, to the extent to which it is attributable to the deduction allowed under this Section. But it any other person receives the annuity, it is to be treated as his unearned income to the extent to which it is attributable to the amount deductible under this Section. The person responsible for paying the annuity is required to deduct tax at the appropriate rates from the amount of annuity payable.

By virtue of an amendment made by the Finance Act 1984 no deduction will be allowed under the provision in relation to the amount paid after 29.2.1984.

Deduction in respect of educational expenses in certain cases. (80F)

The deduction under this Section is available only if all the following conditions are satisfied.

(a) The assessee must be a resident individual and must not be a citizen of India.
(b) During the relevant previous year he should have incurred the expenditure out of his income chargeable to tax in India for the full time education of his child.
(c) The child should be wholly or mainly dependent on him.
(d) The child should be not more than 21 years of age.
(e) The education of the child should be at any University, college or other educational institution situated outside India.

The amount of deduction to which the individual is entitled is :—

(i) Rs. 1,500 if there is only one such child;
(ii) 3,000 if there is more than one child studying abroad.

The deduction is allowable irrespective of the actual amount spent by the assessee.

Deduction in respect of donations to certain Funds, charitable Institutions etc. (80G)

Where an assessee pays any sums as donations then he is entitled to a deduction, subject to certain limitations, from the gross total income.

The following table gives the details of the institutions to which eligible donations can be made, the qualifying amount and the deductions allowable.

Donations naid t	Maximum limit of qualifying amount	Permissible deduction
1	2	3
1. The National Defence Fund set up by the Central Government.	If the aggregate of donated amounts in a previous year is less than Rs. 250/- the benefit of section 80G is not available.	50% of the qualifying amount.
2. The Jawaharlal Nehru Memorial Funds.	No maximum limit is there for items 1 to 5. The entire amount as such donations would qualify for deduction.	50% of the qualifying amount.
3. Prime Minister's Drought Relief Fund	For items 6 to 10 the aggregate of the sums qualifying for deduction will be limited to (1) 10% of the gross total income as reduced by any income on which no tax is payable and by any amount in respect of which the assessee is entitled to a deduction under Chapter VIA. OR (2) 5,00,000 whichever is less.	50% of the qualifying amount.
4. Prime Minister's National Relief Funds.		50% of the qualifying amount

1	2	3
5. National Children's Fund.		50% of the qualifying amount.
6. Institution or fund established in India fulfilling certain prescribed conditions.		50% of the qualifying amount.
7. Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.		50% of the qualifying amount.
8. Statutory bodies (like Housing Boards) established or satisfying needs for housing accommodation, town planning etc. the income of which qualifies for total exemption from tax under section 10 (20A).		50% of the qualifying amount.
9. Government or any approved local authority, institution or association for promotion of family planning.		100% of the qualifying amount.
10. Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any state or states.		50% of the qualifying amount.

The conditions mentioned in item No. 6 above are as follows :

1. The institution or fund is

   (a) constituted as a public charitable trust or

(b) registered under the Societies Registration Act, 1960 or under any corresponding law or under section 25 of the Companies Act, 1956 or

(c) is a University or

(d) is an institution approved by the Central Government for the purposes of section 10 (23) or

(e) is an institution financed wholly or in part by the Government or a local authority.

2. Where such institution or fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10 (22), 10 (22A), 10 (23), 10 (23C), or 11 or 12.

However, it may be noted that the assessee will not lose the benefit of deduction if :

(a) subsequent to the donation any part of the income of the institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or 12 or 12A.

(b) as a result of the operation of section 14(1)(c), exemption under section 11 or 12 is denied to the institution.

3. No part of the income or assets of the institution or fund is transferable or applicable at any time for any purposes other than charitable purpose. Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature.

4. The institution or fund is not expressed to be for the benefit of any particular religious community or caste. An institution or fund established for the benefit of women and children or of Schedule Caste. Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste.

In this connection students may note that donations to item No. 10 are admissible even though those places are for the benefit of a particular religious community.

5. The institution or fund maintains regular accounts of its receipt and expenditure.

Limits with reference to aggregate donations

Section 80G (4) substituted with effect from 1-4-81 clarifies that the limits prescribed therein will apply with reference to the aggregate amount of donations qualifying for deduction and not with reference to the quantum of deduction admissible. The limits are indicated in column 2 of the Table above.

No double deduction : Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the I.T. Act for the same or any other assessment year.

Donations in kind : Explanation 5 to section 80G(5A) provides that donations in kind shall not qualify for deduction.

Nexus with assessees business : The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not

Deduction in respect of rents paid : (80GG)

This benefit is available with effect from the assessment year 1976-77. An employee who does not receive a cash house rent allowance, from an employer in respect of which a total exemption from liability to tax is admissible under section 10(13A) read with Rule 2A or any other assessee who is a self-employed person is entitled to the benefit if certain other conditions are fulfilled.

1 He must incur some expenditure towards payment of rent in respect of any furnished or unfurnished accommodation occupied by him for the purposes of his own residence Thus, if a person resides in his own house, he is not entitled to the benefit.

2. The assessee must be paying a rent in excess of 10% of his total income. Here total income means the assessee's total income after allowing all deductions except the one provided under section 80GG itself

3. The assessee or his spouse or minor child or the Hindu Undivided family of which he may be a member, must not be the owner of any residential accommodation whatsoever.

Amendment by Finance Act, 1983

The Finance Act 1983, has made an amendment in Section 80GG effective from assessment year 1984-85, to provide that deduction in respect of rents paid will be denied only (1) where the assessee owns any residential accommodation at the place where he ordinarily resides or performs duties of his office of employment or carries on his business or profession and (2) where the residential accommodation owned by him is at any other place if it is occupied by him for the purposes of his own residence.

4. Rule 11B stipulates that the accommodation for which the rent is paid and the benefit is claimed must be one situated in any one of the following places namely—Agra, Ahmedabad Allahabad, Amritsar, Bangalore, Bombay, Calcutta, Cochin, Coimbatore Delhi, Hyderabad, Indore, Jabalpur, Jaipur, Kanpur, Lucknow, Madras, Madurai, Nagpur, Patna, Pune, Sholapur, Srinagar, Surat, Trivandrum, Vadodara, Varanasi.

Quantum of benefit : 1. Excess of rent actually paid over 10% of the total income.

2. 15% of total income.

3. Rs. 400 per month whichever is the least.

Deduction in respect of donations for scientific research and rural development : (80GGA)

Section 80GGA grants deduction in respect of the donations made for scientific research and rural development by *any taxpayer* out of the income, included in the gross total income. The whole of the amount of donation would qualify for deduction under this provision as compared to 50 per cent of the qualifying

amount of donation being allowed as a deduction under Section 80G of the Income-tax Act. The amounts qualifying for deduction are :

(i) any sum paid by the assessee in the previous year to a scientific research association which has, as its object, the undertaking of scientific research. or to a University, college or other institution to be used for scientific research : and

(ii) any sum paid by the assessee in the previous year to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of Section 35CCA or to an institution or association which has as its object, the training of persons for implementing programmes of rural development.

It is, however, essential that in respect of both the aforesaid donations, the association or institution to which the donation is given must be approved by the prescribed authority ; in the case of donations for scientific research, the donation must be to the institution approved under Section 35(1) (ii) whereas in the case of donation for rural development the institution or association must be approved by the prescribed authority under section 35CCA(2) of the Income-tax Act.

The benefit of deduction under Section 80GGA would not, however, be admissible in the case of those taxpayers whose total income includes income which is chargeable to tax under the head 'profits and gains of business or profession' since, in the case of those taxpayers the amount of donation would be allowed as a deduction under Section 35 or 35CCA whichever is applicable. Wherever the assessee is entitled to claim the deduction under the new Section 80GGA in respect of any donation, no deduction shall be allowed to the same assessee for the same or for any other assessment year in respect thereof.

Under clause (c) in section 80GGA (2) any sum paid by an assessee (who is not deriving any income under the head 'profits and gains of business or profession) to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources. to be used for carrying out any programme approved under Section 35CCB is also to qualify for and from assessment year 1983-84 for deduction in the computation of his taxable income. It may be noted that deduction in respect of such payment under the head 'Profits and Gains of business or profession' is available under section 35CCB itself.

Amendments by Finance Act, 1983 : 1. The deduction in respect of sums paid to any association or institution for carrying out any programme of rural development or for training of persons for implementing such programmes will be allowed only if the assessee produces a certificate from such association or institution on referred to in sub-section (2) or such section (2A) of section 35CCA

2. Under the new clause (d) deduction will be allowed in respect of any sum paid by an assessee to any rural development fund that may be set up and notified by the Central Government for the purpose of section 35CCA(1)(C).

Deduction of Interest on moneys borrowed to pay taxes. (80 V)

Since 80V allows a deduction from the gross total income of all taxpayers, whether corporate or non-corporate, of a sum equal to the amount of interest, if any, paid by them during the previous year or any money borrowed for the purposes of payment of any tax due from them under the Income tax Act. In order to be allowable as a deduction, the assessee should, however, prove that the amount of interest is actually paid during the accounting year ; it is not enough if the interest is merely payable. The allowability of this deduction presupposes that the assessee had borrowed the money specifically for payment of tax. If the borrowing is not specifically for this purpose, the interest payable thereon would not be allowable as a deduction under this section. Prior to the insertion of this Section interest on moneys borrowed for payment of income tax, which is a personal liability of the taxpayer, was not allowable as a deduction in computing the business income or income from any other source of the taxpayers [Kameswar Singh v. C. I.T. (1961) 41 I.T.R. 774]. There, is, however, no monetary limit in regard to the amount of borrowing, the rate of interest payable or the amount admissible as deduction.

Deduction in respect of expenses incurred in connection with income tax proceedings (80VV)

Secton 80VV provides that in computing the total income of an assessee, a deduction shall be allowed in respect of expenses actually incurred by him during the relevant accounting year in respect of any proceedings before any income-tax Authority, the Appellate Tribunal or any court relating to the determination of any liability to tax under the Income-tax Act, including the liability to penalty or interest This deduction is, however restricted to the amount of Rs. 5,000 for each assessment year. In other words, the deduction allowable to the assessee in respect of expenses incurred for Income-tax proceedings would be either the amount of actual expenses incurred by the assessee or Rs. 5,000 whichever is less Prior to the insertion of this provision expenses in the matter of litigation or other normal proceedings relating to the Income-tax assessment were treated as part of legal expenses and they were allowable in full and without any limits, as an item of business expenses under Section 37(1) of the I.T. Act ; in the case of other tax payers the deduction was not allowable since the provisions relating to the computation of income under the other heads do not contain any specific provision for the allowance of such expenses or a general provision wherein the deduction could be claimed. Now this deduction is available to corporate as well as non-corporate taxpayers.

Deductions in respect of certain incomes :

Deduction in respect of profits and gains from newly established industrial undertakings or hotel business in backward areas : (80HH).

Under this section an assessee will be entitled to the benefit of deduction from gross total income of the sum equal to 20% of the profits and gains derived by him from a new industrial undertaking or the business of a hotel which is established and carried on in any backward area. The benefit, however, is not admissible to an undertaking engaged in mining. The Act has not defined the expression 'Industrial undertaking'. The concept of industrial undertaking need not necessarily be confined to manufacture and production of articles. Thus, a contractor who had undertaken the construction of an irrigation project was held entitled to the benefit of section 80HH. The name of backward areas are given in the Eighth Schedule.

Conditions : This concession is available to any industrial undertaking which fulfills all the following conditions :

1. It began or begins to manufacture or produce articles after 31st December, 1970 in any backward area.

2. It is not formed by the splitting up or the reconstruction of business already in existence in any *backward area*. But the above restriction does not apply to the case of a reconstruction, reestablishment or revival referred to in Section 33B of the Act providing for the grant of a Rehabilitation Allowance.

3. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose in any backward area. However where the total value of the machinery or plant so transferred does not exceed 20% of the total value of the machinery or plant used in the business then the assessee will not be disqualified from claiming the deduction.

4. The undertaking must employ at least ten workers in a manufacturing process carried on with the aid of power or at least twenty workers in a manufacturing process carried on without the aid of power.

In the case of a hotel business, such business must have started or must start functioning after 31st December 1970 in any backward area and such a business should not have been formed by the splitting up or the reconstruction of a business already in existence (*in any area*). In addition, it must be approved for the time being by the Central Government It is significant to note that under Section 80HH, hotel business carried on by any assessee [not necessarily by an Indian company, as in the case of Section 80I] would be eligible for the tax benefit, subject to the satisfaction of the specified conditions.

Period . The deduction of 20% is allowable from the assessee's gross total income in respect of the ten assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or the hotel starts functioning

If the commencement is made after 31st March, 1973 the deduction will be for ten assessment years starting with the assessment year relative to such commencement. But if the commencement is made between January 1, 1971 and March 31, 1973 the ten years are to be reduced by the assessment years which expired before 1st April 1974. The following table will make the position clear.

Previous year	*Commencement*	*Relevant Asst. year*	*Benefit available for*
Calendar year	1971	1972-73	8 asst. years starting from 74-75.
Calendar year	1974	1975-76	10 asst years starting from 75-76.

Audit : Where the assessee is other than a company or a cooperative society the deduction under this section will be admissible only if the accounts of the industrial undertaking or the business of the hotel for the previous year relevant to the assessment year in respect of which the deduction is claimed are audited by a chartered accountant or any other accountant as defined in the Explanation to Section 288(2) and the assessee furnishes along with the return of his income the report of such an audit in the prescribed form (No. 10C) duly signed and verified in the prescribed manner by the accountant concerned.

Transfer of goods at value other than the market value : For the purposes of determining the profits of the undertaking or the hotel, where any goods held, therefore, are transferred to any other business carried on by the assessee or vice versa, the value of the transfer, if not recorded at market rates, will have to be accounted for as at market rates. Thus, if the owner of the undertaking transfers the products of the undertaking to another business carried on by him at Rs. 3,00,000 while the market value thereof is Rs. 5,00,000 the book profits of the undertaking are to be increased by Rs. 2,00,000 to arrive at Section 80HH. On the other hand, if such transfer be at Rs 6,00,000 the book profits have to be reduced by Rs. 1,00,000. Where, however, the computation of the profits in this manner creates exceptional difficulties, the ITO is entitled to resort to estimates.

Colourable transactions : If the assessee owning the undertaking has transaction with other persons with whom he has close connection and due to snch close connection the affairs are so arranged as to produce more than normal profits to the undertaking, the ITO shall take account only of such normal profits in computing the benefit under section 80HH.

80HH deduction to have priority : In a case where the assessee is entitled also to the deduction under Section 80-I or Section 80J in relation to the profits and gains of an industrial undertaking or the business of hotel to which this section applies, effect shall first be given to the provisions of this section.

Deduction in respect of profits and gains derived from newly established small-scale industrial undertaking in rural areas : Section 80HHA grants exemption from income-tax by way of deduction from gross total income to taxpayers deriving income from the business of a new industrial undertaking established in a *rural area* as defined in Explanation (b) to Section 35CC(1). This exemption is available to all taxpavers, both corporate and non-corporate, but the industrial undertaking, the profit from which qualifies for deduction, should be *small scale industrial undertaking* For this purpose, an industrial undertaking would be deemed to be small scale industrial undertaking if the aggregate value of machinery and plant (other than tools, jigs, dies and moulds) installed as on the last day the accounting year for the purpose of the bu iness of the industrial undertaking does not exceed Rs. 1,00.000.

Amendments made by the Finance Act, 1981

As a result of the amendments made by the Finance Act, 1981, in Section 80HH in cases where the previous year ends after 31st July, 1980, the limit in r[illegible]g[illegible]ate value of machinery or plant installed as on the last date of the relevant previous year would be Rs. 20 lakhs. Further, the benefit of tax concession

under Section 80HHA has been extended to industrial undertakings which did not qualify for the same before that date on the ground that the aggregate value of machinery or plant installed therein exceeded Rs. 10 lakhs but did not exceed Rs. 20,00,000. In such cases, the concession will be available for the unexpired period.

(i) In the case of any machinery or plant owned by the assessee, the value thereof should be taken to be its actual cost to the assessee as defined in Section 43(1).

(ii) In the case of any machinery or plant hired by the assessee, its actual cost, which would have been taken in the case of the owner of such machinery or plant would be regarded as the value of the machinery or or plant to the assessee.

The admissibility of this deduction pre-supposes that profits and gains are derived from the new industrial undertaking and such profits are included in the gross total income of assessee for the relevant assessment year commencing from 1st April, 1978 or any subsequent year. The amount of deduction is a sum equal to 20 per cent of the profits and gains derived by the assessee during the previous year and included in the gross total income.

The allowance of this deduction is also subject to the further condition that the small-scale industrial undertaking which has been newly established, begins to manufacture or produce articles at any time on or after 1st October, 1977 in any rural area and it is not formed by the splitting up or the reconstruction of a business already in existence. However, the condition in regard to the splitting up or reconstruction of a business already in existence being taken as the basis for the formation of a new industrial undertaking would not apply in respect of any small-scale industrial undertaking which is formed as as a result of the re-establishment, re construction or revival by the assessee of the business of any such industrial undertaking which is discontinued, damaged or destroyed, as a result of the factors beyond the assessee's control entitling the assessee to the benefit of rehabilitation allowance under Section 33B of the income-tax Act in those circumstances and within the time-limit of three years specified in that Section.

The new industrial undertaking should not have been formed by the transfer to the new business of machinery or plant previously used for any purpose. However, in cases where any machinery or plant or any part thereof previously used for any purpose is transferred does not exceed 20 per cent of the total value of the machinery or plant used in the business of the new industrial undertaking, then the assessee would be deemed to have complied with the condition. Accordingly, in such cases there would be no question of denial of the benefit of deduction admissible to the assessee under a new Section 80HHA. Another important condition which should be fulfilled by the new units is that it should employ 10 or more workers in a manufacturing process carried on with the aid of power or 20 or more workers in a manufacturing process carried on without the aid of power.

This deduction is available to taxpayers for a period of *ten* consecutive assessment year beginning with the assessment year relevant to the accounting year in which the small-scale industrial undertaking begins to manufacture or produce articles or things. The amount of deduction is dependent upon the quantum of profits

derived from the new industrial undertaking and the amount thereof remaining in the hands of the assessee after the set off of losses, depreciation allowance, investment allowance, etc.

In cases where the new industrial undertaking is one in respect of the profits of which the tax-holiday benefit is also to be granted to the assessee under Section 80J, the benefit of deduction under Section 80HHA would be first allowed and only in respect of the balance of the profits remaining in the hands of the assessee, the question of deduction under Section 80J would arise.

Where the new industrial undertaking is one in respect of the profits of which the deduction under Section 80HH is admissible by virtue of the new industrial undertaking being established in backward area the assessee would not, in respect of the same industrial undertaking, be entitled to the deduction under Section 80HHA also. Similarly, when the new industrial undertaking is established in a rural area and the provisions of Section 80HHA are applicable to the assessee, the provisions of Section 80HH would not also apply to grant deduction in respect of the same profits. In other words, the assessee would not be eligible for deduction in respect of the profits from the same industrial undertaking under Section 80HH as well as Section 80HHA.

The provisions relating to audits for the specific purpose of getting the deduction applicable to non-corporate taxpayers under Section 80HH (5) would also be applicable to taxpayers, other than companies and co-operative societies for allowance of this deduction under Section 80HHA. The Audit Report should be in the prescribed form (Form No. 10CC) duly signed and verified by the auditor containing such particulars, as are required for the purpose ; the Audit Report should be enclosed with the return of the assessee for each of the relevant assessment year for which benefit of deduction is admissible. The form of Audit Report has been prescribed under Rule 18BB.

The provisions of Section 80HH(6) and (7) for the purpose of substituting the fair market value of the goods transferred by the assessee from or to the new industrial undertaking for the consideration recorded in the accounts of the business and for the purpose of arriving at reasonable profits made from the business in the place of profits as per books would also apply in the case of industries established in rural areas for the purpose of computation of the profits on which deduction is allowable in the same manner and to the same extent as they would apply under Section 80HH(6) and (7) in the case of industries located in backward areas.

Any small-scale industrial undertaking which is engaged in the business of mining is not entitled to the deduction under the new Section 80HHA.

Deduction in respect of profits and gains from projects outside India ; 80HHB.

The Finance Act, 1982 has inserted a new section 80HHB with effect from 1.4.1983. This new section provides for deduction in respect of profits and gains from projects outside India and this is meant to encourage contractors to undertake construction and engineering contracts outside India.

Eligible assessees : This relief is available from the assessment year 1983-84 to Indian companies and non-company assessees who are residents in India in respect of eligible profits and gains.

Eligible Profits and Gains : The profits and gains which are eligible for tax relief under section 80HHB are those derived from the business of -

(i) the execution of a foreign project undertaken by the assessee in pursuance of a contract entered into by him.

(ii) the execution of any work undertaken by the assessee and forming part of a "foreign project" undertaken by any other person in pursuance of a contract entered into by such other person.

The above contract should be entered into with the Government of a foreign State or any statutory or other public authority or agency in a foreign state or a foreign enterprise, and the consideration for such work should be payable in convertible foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purpose of FERA, 1978.

Foreign project means a project for --

(i) the construction of any building, road, dam, bridge or other structure outside India.

(ii) the assembly or installation of any machinery or plant outside India ;

(iii) the execution of such other work (of whatever nature) as may be prescribed.

Conditions : The deduction can be allowed only if the following conditions are satisfied :

(1) separate accounts should be maintained by the assessee in respect of eligible profits and gains. For assessees other than companies and co-operative societies audit is compulsory and such audit report should be attrached to the return of income.

(2) An amount equal to 25% of the eligible profits and gains should be debited to the profit and loss account of the previous year in which the deduction under this section is to be allowed and credited to a "Foreign Projects Reserve" Account to be utilized by the assessee during a period of five years for the purposes of the business other than for distribution by way of dividends or profits.

(3) An amount equal to 25% of the eligible profits and gains is brought by the assessee in 'convertible foreign exchange' into India within a period of six months from the end of the previous year or within such further period as may be allowed by the commissioner by an order in writing recording the reasons therefor.

Quantum of deduction : (1) 25% of the eligible profits and gains. (2) Where the amount credited to the Foreign Projects Reserve Account (FPRA) or the amount brought into India or either of these amounts is less than 25% of the eligible profits and gains, the deduction under this section is to be restricted to the

amount so credited to the FPRA or the amount actually brought by him into India, whichever is less.

Forfeiture on breach : Section 80HHB(4) provides that if, at any time before the expiry of five years from the end of the relevant previous year, the assessee utilises the amount credited to the FPRA for the purpose of distribution by way of dividends or by way of dividends or by way of profits or any other non-business purpose, the deduction which had been originally allowed to him under section 80HHB(1) is to be deemed to have been wrongly allowed. For this purpose the ITO has been empowered to recompute the total income of the assessee for the relevant assessment year and withdraw, by way of rectification, the tax benefit granted to the assessee. Such rectification order is to be made within a period of four years from the end of the previous year in which the amount was so utilised.

Ban on double deduction : Section 80HHB(5) enacts that no part of the consideration or of the income comprised in the consideration payable to the assessee for the execution of a foreign project or any other work shall qualify for deduction for any other assessment year under any such other provision (80 HH, 80HHA, 80I to 80TT).

Deduction in respect of Export Turnover (Section 80HHC) :

The Finance Act 1983 has inserted a new section 80HHC in the Income-tax Act relating to deduction in respect of export turnoevr w.e.f. 1.4.1983. Accordingly if a taxpayer being an Indian company or a person (other than a company) who is resident in India exports out of India during the previous year any goods or merchandise to which this section applies, he will be allowed the following deductions :

1. A deduction of an amount equal to one per cent of the export turnover of such goods or merchandise during the previous year, and

2. deduction of an amount equal to five per cent of the amount by which the export turnover of such goods or merchandise during the previous year exceeds the export turnover of the goods or merchandise during the immediately preceding previous year.

The new section applies to all goods or merchandise other than agricultural primary commodities, not being produce of plantations ; mineral oil ; minerals and ores and such other goods or merchandise as the Central Government may by notification in the official Gazette specify in this behalf. This concession will apply to sale proceeds of such goods or merchandise exported out of India as are receivable by the taxpayer in convertible foreign exchange.

This deduction will not be allowed unless taxpayer had, during the immediately preceding previous year exported out of India goods or merchandise to which this section applies.

Section 80 HHC will be effective from 1.4.1983 (83-84 assessment year).

Deduction in respect of profits and gains from industrial undertaking after a certain date etc : (80-I)

The benefit of tax holiday, for a new industrial undertaking, new cold storage plant, new hotel or new ship, which used to be available under section 80J, ceased

to be operative in respect of any undertaking, cold-storage plant, hotel or ship commencing operations after 31st May, 1981. The scheme of benefit under section 80 J has been replaced by a new scheme of tax-holiday, enacted in section 80-I by the Finance (No. 2) Act, 1980 effective from April 1, 1981.

80-I and 80J : In some respects the provisions of section 80-I and 80J are similar. There are, however, important differences also.

Similarities : Conditions to be fulfilled by industrial undertaking, ships and hotels to be eligible for the deduction are similar.

Differences : 1. Under section 80I deduction is allowed as a percentage of profits of the eligible undertaking, Under section 80J such deduction is allowed as a percentage of capital employed in the undertaking, hotel or ship.

2. Under 80 I there is no benefit of carrying forward any "deficiency" whereas 80J contains such a benefit.

3. 80J does not contain a provision like 80-I(6) the contents of which are explained in the following pages.

Nature of benefit under section 80-I

Section 80-I provides for a deduction from the profits of an eligible industrial undertaking, cold storage plant, hotel or ship of an amount equal to 25% of such profits where the assessee owning the undertaking, plant, hotel or ship is a company and 20% where the assessee is other than a company.

Duration of benefit : The benefit is to be allowed in eight consecutive assessment years, the first such assessment year being the assessment year relevant to the previous year in which

(i) in the case of an industrial undertaking it begins to manufacture or produce articles or things :

(ii) in the case of cold storage plant, it begins to operate.

(iii) in the case of a ship, it is first brought into use; and

(iv) in the case of a hotel, it starts functioning.

The first assessment year is termed in the Act as the "intitial assessment year".

For a cooperative society, the benefit is available for ten consecutive assessment years commencing with the initial assessment year.

Conditions to be fulfilled by the above entities :

1. **Industrial undertakings**

(a) It should not be formed by the splitting up, or the reconstruction of a business already in existence ; but this restriction does not apply in respect of an industrial undertaking to which the provision of section 33B applies.

(ii) [illegible] not be formed by the transfer to a new business of machinery or plant previously used for any purpose. If, however, the total value of such transferred machinery or plant does not exceed 20% of the total value of all the machinery or plant used in the undertaking the benefit under section 80-I will not be denied.

It [illegible] even though the machinery or plant has been previously used [illegible] machinery or plant previously used for any purpose [illegible] conditions should be fulfilled for the above purpose.

(1) The plant or machinery had been used outside India.

(2) The user was a person other than ths assessee.

(3) Such machinery or plant had not at any time previous to the date of the installation by the assessee, used in India.

(4) Such machinery or plant is imported into India from any country outside India.

(5) No deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

(c) The undertaking manufactures or produces any article or thing, not being any articles or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India, and begins to manufacture or produce articles or things or to operate such plants or plants at any time within the period of four years next following March 31, 1981, or such further period as may be notified.

The above restriction regarding articles and things specified in the Eleventh Schedule does not, however apply to a small-scale industrial undertaking. A small-scale industrial undertaking in this context means an industrial undertaking the aggregate value of the machinery or plant (other than tools, jigs, dies and moulds) installed which, as on the last day of the previous year for the purposes of the business of the undertaking does not exceed Rs 20 lakhs. The "value" for this purpose means the actual cost of the machinery or plant io the owner thereof where the assessee is the owner and in the case of any machinery or plant hired by the assessee the actual cost to the owner of such machinery.

(d) In a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

2. **Ships** : (a) The ship is owned by an Indian company and is wholly used for the purposes of business carried on by it.

(b) previous to the date of its acquisition by the Indian company, it was not owned or used in Indian territorial waters by a person resident in India.

(c) it is brought into use for the first time by the Indian company at any time within the period of four years next following April 1, 1981.

3. **Hotels : (a)** The business of the hotel is not formed by the splitting up, or the reconstruction, of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose

(b) the business of the hotel is owned and carried on by an Indian company with a paid-up capital of not less than Rs. 5 lacs

(c) the hotel is for the time being approved for the purposes of section 80-I by the Central Government.

(d) the business of the hotel starts functioning after 31st March 1981 but before April 1, 1985.

Industrial undertaking, Ship or Hotel to be treated as the only source of Income

In the case of *CIT v Patiala Flour Mills Co P Ltd* (1978) 115 ITR 640 (SC) the Supreme Court negatived the contention of the revenue that before granting the benefit under section 80J, and loss, depreciation, or development rebate arising in the unit should be carried forward and adjusted against the unit's profit for any subsequent assessment year *even though such loss depreciation or development rebate had already been fully absorbed by the assessable profits of the assessee from his other units in the prior year itself.*

Section 80-I(6) was enacted to over-rule this decision. It provides that for the purposes of determining the quantum of deduction under section 80-I for the initial assessment year and the subsequent assessment years, the industrial undertaking, ship or hotel is to be regarded as the only source of income

This in effect would mean that the earlier years' losses and unabsorbed depreciation, etc. of that particular unit, *even if absorbed by profits from other sources, shall have to be carried forward notionally and adjusted from the current profits* of the new industrial unit, for the purposes of determining the quantum of relief available under Section 80-I

The implication of the above provision is illustrated below :

Bharat Industrial Enterprises Private Limited is engaged in manufacturing activities. It has a manufacturing unit in Ahmedabad, engaged in the production of certain electronic products, since 1966. It established in February 1982 a new industrial unit manufacturing a new product, hitherto purchased by the company from outside market. The new unit started production on 15th April, 1982 and it satisfied all the conditions specified in Section 80I During the previous year ending 31st December, 1982 the following details of the old and new units are available :

	Old unit	*New unit*
	Rs.	Rs.
Profits before depreciation and Investment allowance	25,00,000	50,000
Depreciation (including additional depreciation)	5,00,000	3,00,000
Investment Allowance	2,00,000	5,00,000

During the previous year ending 31st December, 1983, **the particulars of the** *old and the new undertakings were as follows :*

	Old unit Rs.	*New unit* Rs.
Profits before depreciation and Investment Allowance	30,00,000	20,00,000
Depreciation (including additional depreciation)	4,50,000	1,85,000
Investment Allowance	— —	37,500

The company wants to know whether it can claim deduction under Section 80I in respect of the units, for the assessment years 1983-84 and 1984-85 and if so the quantum of such benefit.

Bharat Industrial Enterprises Limited

Computation of Total Income for Assessment Year 1983-84

	Old unit Rs.	*New unit* Rs.
Profit before depreciation and Investment Allowance	25,00,000	50,000
Depreciation		
Old unit—	5,00,000	
	20,00,000	
New unit—Depreciation to be claimed against profits of new unit (out of a total of Rs. 3,00,000)		50,000
Depreciation of new unit claimed against profits of old unit (3,00,000 – 50,000)	2,50,000	
	17,50,000	
Investment Allowance— Old unit—2,00.000 New unit—5,00,000	7,00,000	
Gross Total Income/Total Income	10,50,000	

As the gross total income of the assessee does not include any profits and gains derived from the new industrial undertaking, no deduction under Section 80I could be claimed for the assessment year 1983-84. The income from the new unit computed in accordance with the provisions of this Act before making any deduction under Chapter VIA, is nil and consequently as per the provisions of Section

80AB, no income from the new unit shall be deemed to be included in the gross total income and consequently no deduction could be claimed under Section 80I.

The position for the assessment year 1984-85 will be as follows :

	Old unit Rs.	New unit Rs.
Profits before Depreciation & Investment Allowance	30,00,000	20,00,000
Depreciation—Old unit	4,50,000	
New unit		1,85,000
	25,50,000	18,15,000
Investment Allowance		37,500
	25,50,000	17,77,500
Gross Total Income		43,27,500
Less : Deduction under Section 80I		
Computation of Profits for the purposes of determining the quantum of deduction under Section 80I—[Section 80I(6)]		
Less : Profits—	17,77,500	
Depreciation & Investment Allowance of the new unit for the previous year ending 31-12-81, set off against the profits of old unit	7,50,000	
	10,27,500	
Deduction under Section 80I restricted to 25% of Rs 10,27,500		2,56,875
	Total Income	40,70,625

Under the provisions of section 80I(6), for the purposes of determining the quantum of deduction under Section 80I, the profits and gains of the new industrial undertaking shall be computed as if such industrial undertaking were the only source of income of the assessee during the previous year relevant to the assessment year, for which the assessee is entitled to deduction under Section 80I. This specific provision supersedes the Supreme Court's decision in the case *C I T.* v. *Patiala Flour Mills. Co (P) Ltd.* (*1978*) *115 I T.R. 640*, and consequently even if the business losses unabsorbed depreciation, investment allowance etc. of the new unit, are absorbed by the profits of any old unit or any other source of income owned by the same assessee, subsequently, when the new unit starts yielding profits, for the purposes of determining the quantum of deduction under Section 80I, such past losses depreciation, Investment allowance etc. should be brought forward notionally on the

assumption, that the new industrial unit is the only source of income owned by the assessee. In this case, however, only the depreciation and investment allowance relating to the new unit have been absorbed by other profits and no losses of the new undertaking have been so absorbed.

In view of this position, Bharat Industrial Enterprises Pvt. Ltd. can claim the benefit of deduction under Section 80I only for the assessment year 1984-85 and even for that purpose the profits have to be computed under Section 80I(6) in the manner indicated above.

Compulsory Audit : For an assessee other than a company or a cooperative society, to get the benefit of deduction under section 80I, it must have the accounts of the undertaking for the relevant previous year duly audited and produce the auditor's report in the prescribed form along with the return.

Transaction between a new unit and other units of the assessee :

There may be departmental transfers of goods, an existing unit supplying goods to the new unit or the new unit supplying its products to the existing units. If the transfers are at values which do not correspond to the market value of the goods as on the date of the transfer, then for the purposes of the deduction under section 80 I, the profits and gains of the undertaking are to be computed as if the transfer were made at such market value But if computation presents exceptional difficulties the ITO may compute the profits on such reasonable basis as he may deem fit

Transactions between closely connected persons :

Where the assessee arranges transactions between the new unit and closely connected persons in such a way as to produce more than the ordinary profits which might be expected to arise in the new unit, the ITO is entitled to substitute for the stated profits such ordinarily expected profits for the purposes of determining the quantum of benefit under Section 80-I

Power of Central Government : The Central government has power to direct by notification that the exemption under section 80-I shall not apply to any particular class of industrial undertaking with effect from a particular date.

The Finance Act 1983 has made the following amendments to section 80-1.

Where the gross total income of an assessee being an Indian company includes any profits and gains derived from the business of repairs to ocean-going vessels or other powdered craft, a deduction shall be allowed of 20% of such profits in the initial assessment year and each of the four succeeding assessment years, subject to the fulfilment of certain conditions (similar to those to be filled up by hotel or shipping businesses) Such business should have commenced after the 31st March, 1983 but before 1st April 1988 and must, for the time being, be approved by the Central Government.

This amendment will apply from 1984-85 assessment year onwards.

Example : Mr. A set up a new industrial undertaking in a notified backward area in May 1983. The industrial undertaking commenced its business of manufac-

ture of a priority item in June 1983. During the previous year ended 31st Dec. 1983, Mr. A's Gross Total Income includes Rs 2 lakhs derived from the new industrial undertaking. The value of plant and machinery of the undertaking was Rs. 10 lakhs as on 31st Dec. 1983.

During the year it had exported goods woith Rs. 5 lakhs outside India. The sale proceeds are received in convertible foreign exchange. Indicate the deduction allowable from Gross Total Income of Mr. A in respect of the above transactions.

Answer : Mr. A set up a new industrial undertaking in a notified backward area. The total value of plant and machinery as on the last day of the previous year i e., 31st Dec. 1983 was Rs 10 lakhs. So it is a small scale industrial undertaking as per Explanation given under Sec. 80HHA. The small scale industrial undertaking is engaged in the business of manufacturing a priority item Hence Mr. A would be entitled for deduction under Sec. 80HH, Sec. 80HHA, Section 80I in respect of profits and gains of industrial undertaking included in his Gross Total Income for the relevant previous year. But the assessee cannot claim the benefit of deduction both under Sections 80HH and 80HHA in view of the specific provisions of sub-section (9A) of Section HH which provides that no deduction would be allowed under that section in respect of profits and gains in relation to which deduction is allowable and claimed under Section 80HHA. Hence the assessee would be entitled to claim deduction under Sections 80HH or Section 80HHA.

It is assumed that the assessee has opted for claiming deduction under Section 80HH. So, the assessee is entitled for a deduction of 20% of Rs. 2,00,000 i.e., 40,000 under Section 80HH.

The quantum of deduction allowable under Sec. 80I shall be 20% of profits and gains from industrial undertaking as reduced by the deduction allowed under Section 80HH i e. 20% of Rs. 1,60,000 [Rs. 2,00,000—Rs. 40,000]=Rs. 32,000.

As per Sec 80HHC, Mr. A shall be entitled for deduction of one per cent of sale proceeds of export goods made outside India during the previous year i e., one per cent of Rs. 5 lakhs=Rs. 5,000. Assuming that Mr. A did not make any exports during the previous year ended 31st Dec. 1982, no further deduction is allowed as envisaged in Sec. 80HHC(1) (b) read with sub-section (3).

Hence Mr. A shall be entitled for an aggregate deduction of Rs. 77,000 [Rs. 40,000, Rs. 32,000 and Rs. 5,000 under Sec. 80HH, 80-I and Sec. 80HHC respectively] from his Gross Total Income for the previous year ended 31st Dec. 1983 relevant to the assessment year 1984-85.

Deduction in respect of profits and gains from newly established industrial undertakings or ships or hotel business in certain cases : (80J).

The tax holiday provisions of Secion 80J have got only limited importance now in view of the fact that the benefit under the provisions of Section 80J would be available only in relation to new industrial undertakings which went into production *before 1st April, 1981* or approved *hotels* which started functioning *before that date* or new *ships* which were brought into use on or *before that date.*

The tax holiday concessions under Section 80J consists of exemption of income-tax on the profits upto 6% per annum (7.5% per annum in the case of

companies) of the capital employed in the industrial undertaking, hotel or ship for five successive assessment years commencing from the assessment year relevant t the previous years in which the undertaking goes into production or starts operation of the cold storage plant or the hotel starts functioning or the ship is first put to use. The deduction is to be made in respect of the profits and gains of the industrial undertaking included in the gross total income as reduced by the deduction, if any, allowable under section 80HH or 80HHA. In the case of co-operative society, the tax holiday period extends to seven years as against five years in the case of other categories of assessees. An industrial undertaking which began to manufacture or produce any article specified in the list of the Eleventh Schedule to the Income-tax Act after 31st March, 1979 is not eligible for this tax concession.

The tax holiday benefit is based on a specified percentage of the capital employed. The capital employed in the industrial undertaking or a ship or the hotel is computed on the basis laid down in sub-section (1A) of Section 80J.

Under this sub-section capital employed is computed on the basis of owned capital and reserves only and the value of the total assets of the assessee are reduced by the liabilities including long-term borrowings.

Section 80J (3) allows the benefit of carry forward of and set off of the 'deficiency' in the profits for the period of five years in the case of assessees other than cooperative societies and seven years in the case of cooperative societies. The provisions as regard the computation of deficiency and its set off are as follows :--

(1) The term "deficiency" in the context refers to the amount of difference between the relevant amount of the capital employed during the previous year and the amount of profits and gains derived from the industrial undertaking or ship or the business of the hotel, as the case may be, included in the gross total income as computed without applying the provisions of Section 64 and before making any deduction under Chapter VIA or section 280-O. In cases where there are no such profits and gains, the word "Deficiency" will refer to the relevant amount of capital employed during the previous year.

(2) The deficiency for each year shall be computed separately and added in on cumulative basis so as to prevent the loss of one year from the set off against the profits of any earlier years during the five years or seven years period. If there being more than one deficiency the deficiency brought forward from the earlier previous year shall have priority over the efficiency of the subsequent previous year for the purpose of setting it off.

(3) The assessment year in respect of which the deficiency is to be carried forward must not be an assessment years prior to the initial assessment year or subsequent to the four or six assessment year, as the case may be, as reckoned from the end of the initial assessment year.

(4) The deficiency of one year is to be carried forward and set off against the profits and gains of the industrial undertaking, hotel or ship after the deduction, if any, available to the assessee under Section 80HH or 80HHA for the next following assessment years. However, in new

industries, the deficiency or part thereof shall not be carried forward beyond seven assessment years, as reckoned from the end of the initial assessment year.

(5) Where the assessee is entitled to a deduction under Section 80HH or Section 80HHA and 80J, the deduction under Section 80HH or 80HHA should be first allowed and only thereafer the deduction under Section 80J should be allowed.

Students may note that the provisions of section 80J are similar to those of section 80I in respect of the following matters :

1. Conditions to be fulfilled by industrial undertakings, ship, hotel.

2. Audit.

3. Transactions between the new units and the other units belonging to the assessee.

4. Power of the Central Government.

Deduction in respect of profits and gains from business of livestock breeding or poulrty or dairy farming : (80 JJ).

According to this provision an assessee deriving income from the business of live-stock breeding or poultry or dairy farming would be entitled to deduction, in the computation of his total income, of an amount equal to one-fifth (15 per cent from 1-4-1984 as per Finance Act 1983) of the aggregate of the income derived from these sources or Rs. 15,000, whichever is higher. Where the aggregate of such income does not exceed Rs. 15,000, the whole of such income will be extempt from tax. It computing the deduction under this Section in a case where the profit derived from the business of poultry farming exceeds Rs 75,000 (Rs. 1,00,000 w.e.f 1.4 1984 as per Finance Act 1983) the excess will be ignored.

Deduction in respect of profits and gains from business of growing mushrooms : (80 JJA)

The Finance Act, 1979 has inserted a new Section 80JJA in the Income-tax Act, with effect from 1st April, 1980 to grant a deduction from gross total income in cases where the gross total income of the assessee (whether corporate or non-corporate and whether resident or non-resident) includes in profits and gains derived from the business of growing mushrooms provided that such profits and gains are not in the nature of agricultural income. The amount of deduction shall be a sum equal to 1/3rd of such profits and gains or Rs. 10,000, whichever is less.

As per the Finance Act 1983, 80JJA will be omitted w.e.f. 1984-85 assessment year.

Deduction in respect of dividends attributable to profits and gains from new industrial undertakings or ships or hotel business : (80K)

A shareholder of a company is not liable to pay income-tax in respect of so much of dividends received by him from the industrial undertaking, or ship as is

attributable to the tax-holiday profits exempt from tax in the hands of the industrial undertaking or hotel or ship under section 80J. The assessee is allowed a deduction from his gross total income of the amount of such dividends to the extent to which they relate to the 'tax holiday' profits of the company computed as per Rule 20 of the Income-tax Rules 1962. The benefit of this deduction is available to the beneficial owners of the shares who need not necessarily be the registered shareholders.

The proviso to Section 80K of the Income tax Act provides that no deduction under this Section shall be allowed in respect of any income by way of dividends which is attributable to the profits and gains derived by a company from a new industrial undertaking which begins to manufacture or produce articles or to operate a cold storage plant at any time after 31st March, 1976 or from a ship which is brought into use after that date or even from the business of a hotel which started functioning after that date.

In other words such dividends are not exempt at all. Thus section 80K has now become considerably restricted in its operation.

Deductions in respect of interest on certain securities : (80L as amended by Finance Act, 1984)

The income derived from any of the following sources will be exempt from income-tax in the case of individuals and Hindu undivided families, subject to a maximum of Rs. 7,000

(i) Interest on any security of the Central Government or a State Government issues come under this category. For instance, interest of NSC-VI and VII.

(ii) Interest on such debentures of co-operative societies (including co-operative land mortgage banks and co-operative land development banks) or other institutions or authorities as are notified by the Central Government. [The debentures issued by State Electricity Boards after 1-4-1972 and the Industrial Finance Corporation of India have been notified in this regard].

Interest on deposits under such National Deposit Scheme as may be framed by the Central Government and notified by it in this behalf in the Official Gazette.

(iii) Interest on deposits made under any scheme framed by the Central Government and notified in this behalf : [The Post Office Time Deposits and Post Office Recurring Deposits have been notified for this purpose].

(iv) Dividends from Indian companies.

(v) Income from the Unit Trust of India.

(vi) Interest on deposits with banking companies and co-operative societies carrying on banking business including co-operative land mortgage banks and co-operative land development banks.

(vii) Interest on deposits with a financial corporation engaged in providing long term finance for industrial development in India and which is approved by the Central Government for the purpose of Section 36 (1)(viii)

(vii *a*) Interest on deposits with any bank, other than a banking company or a cooperative society referred to in (viii) above which may be approved by the Central Government.

(viii) Interest on deposits with a co-operative society [other than a co-operative society referred in (vi) above] made by a member of the society—with effect from 1-4-1972.

(ix) Dividends from any co-operative society.

(x) Interest on deposits with housing boards.

(xi) Interest on deposits with approved financial corporations providing term finance for industrial development or approved public companies providing long term finance for construction or purchase of houses in India for residential purposes.

Under the Compulsory Deposit (Income-tax Payers) Act, 1974 the interest received bp the tax-payers on their deposits would also qualify for deduction under Section 80L. Likewise, the interest received by employees on their additional wages and dearness allowance frozen under the Additional Emoluments (Compulsory Deposit) Act, 1974 would also quality for deduction under this Section as interest from banks).

Additional deductions : The Finance Act, 1984 has added two provisos to section 80L(1) with effect from 85-86 assessment year.

1. The first proviso places investment in units of the Unit Trust of India and investment in National Deposit Scheme on par and allows a further deduction of Rs. 3,000 from income derived from these two sources.

2. The second proviso provides for a further deduction of Rs. 2,000 in respect of income derived from investment in National Deposit Scheme.

3. **Additional Exemption in respect of Units in the case of non-residents.** In addition to the exemption available under Section 80L in respect of income from specified sources including units, which is available to all individual and Hindu undivided family assessees, there is a special exemption in respect of units applicable to non-resident. As a result of the amendment made by the Unit Trust of India (Amendment) Act, 1976 income earned from Units of the Unit Trust of India purchased by non-resident Indians and aliens of Indian origin from Non-Resident (External) accounts or through remittance of-foreign exchange will be free of income-tax. There is no monetary ceiling in this regard.

Students may note that the additional deduction of Rs. 3,000 available in respect of income from units under Unit Trust of India Act, 1963 will be withdrawn from 85-86 assessment year, since the same has been incorporated in section 80L(1) of the Income-tax Act itself.

Where the total income of an assessee also includes any dividends which are exempt from tax under Section 80K as being attributable to the tax holiday profit of companies, only that part of dividends in respect of which deduction is not allow-

able under the Section (80K) will be taken into account for the purpose of allowing the deduction under this Section.

Deduction in respect of certain intercorporate dividends : (80 M)

Section 80M provides for concessional tax treatment of intercorporate dividends. Till 84-85 assessment year full deduction will be granted in respect of income by way of dividends received by a domestic company from an *Indian company* formed and registered under the Companies Act, 1956 after 28th February, 1975 and engaged exclusively or almost exclusively in the manufacture or production of any one or more of the specified articles in this connection,

In respect of such income by way of dividends other than the dividends referred to above the deduction is allowed at the rate of 60 per cent of such dividend income.

However, by virtue of an amendment made by the Finance Act, 1984, this differential concession has been abolished and a uniform rate of deduction at 60% for all inter corporate dividends will be available from 85-86 assessment year onwards.

The income by way of dividends is charged to tax under the head "Income from other sources" and is computed after making the deduction firstly, in respect of any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purposes of realising such dividends on behalf of the company and, secondly in respect of any other expenditure, not being capital expenditure laid out or expended wholly or exclusively for the purpose of making or earning such income, e.g., interest paid on borrowings utilised for the purchase of shares, etc.

Section 80AA provides that the deduction under Section 80M in respect of inter-corporate dividend will be calculated with reference to the net dividend income as computed in accordance with the provisions of the Income-tax Act (before making any deduction under Chapter VIA) and not with reference to the gross amount of such dividends. Students may refer to the general introduction for Chapter VIA to understand the significance of the provisions of section 80AA.

The Finance Act, 1983 has omitted section 80MM with effect from the assessment year 1984-85.

Deduction in Respect of Dividends from Certain Foreign Companies (Section 80N) : *Indian companies* receiving dividends from foreign companies on shares allotted to them by the latter in consideration of any patent, invention, design, model, secret formula or process or similar property right, information concerning industrial, commercial or scientific knowledge, experience and skill provided by them to the foreign companies are entitled to a deduction of the *whole* of such dividends (50% of such dividends from 85-86 assessment year onwards) from their gross total income.

This deduction is available to the assessee even in respect of dividends on shares allotted in consideration of any technical knowhow provided by it to the foreign company if it is provided under an agreement approved by the Board for

this purpose the application for which should have been made before 1st October of the relevant assessment year.

The deduction under Sec. 80N would be available to the Indian company *only if* the dividend income is brought into India in accordance with the Foreign Exchange Regulation Act and the rules made thereunder. The deduction mentioned in the Section should be allowed only with reference to the income referred to which is received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, by or on behalf of the assessee is subsequently brought into India in accordance with the law for time being in force for payments and dealings in exchange.

For the purposes of this section "convertible foreign exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purpose of Foreign Exchange Regulation Act.

It is possible that the assessee might use some portion of the income outside India. If such income is used outside India in the manner permitted by the Reserve Bank of India then it shall be deemed to have been brought into India in accordance with the Foreign Exchange Regulation Act on the date on which such permission is given.

It is likely that in some cases there might be considerable time lag between the accrual of income in a foreign country and its remittance to India and accordingly a situation may arise where foreign income may not be received in India before the completion of regular assessment for the year in which it becomes chargeable to tax in the case of a tax-payer maintaining accounts on mercantile basis. A similar difficulty may also arise in cases where a host country may place restrictions on remittance of funds to India and the income otherwise qualifying for exemption may not be received in India before the assessment is made. In order to obviate these difficulties section 155(11) provides that in cases where the deduction under section 80N was not allowed in any year in respect of the whole or any part of the income by way of dividends on the ground that such income had not been received in convertible foreign exchange in India or having been received in convertible foreign exchange outside India, had not been brought into India by or on behalf of the tax-payer in accordance with the foreign exchange regulations and subsequently such income or part thereof is received in or brought into India in accordance with these regulations, it will be open to the income-tax officer to rectify the original assessment so as to allow the deduction in respect of income so received in or brought into India. The rectification will be permissible within the period of four years from the date on which such income is receivedin or brought into India.

Deduction in respect of royalties etc., from certain foreign enterprises : (80-0)

Under this Section an Indian company is entitled to a deduction from gross total income in respect of the whole of the royalties, commission, fees or other similar payment included in the gross total income. From 85-86 assessment year onwards the deduction will be restricted to fifty per cent of such income included in assesseess Gross Total Income. The provisions in this regard are as under ;—

(i) The income by way of royalties etc., should have been received by the assessee from the Government of foreign State or a foreign enterprise. For this purpose it is immaterial whether the foreign enterprise is a company or not.

(ii) The income must have been received (a) in consideration for the use outside India of any patent, invention, model, design, secret formula or process or similar property right or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided or (b) in consideration of technical services rendered by the assessee to the foreign government or enterprise.

(iii) The deduction will be admissible only in cases where the technical services are rendered or the technical know-how is provided to a foreign government or enterprise under an agreement approved by the Central Board of Direct Taxes for this purpose.

(iv) The application for approval must be made to the Board before the 1st October of the assessment year in relation to which the approval is first sought by the assessee.

(v) The other conditions relating to the receipt of this income in convertible foreign exchange and its remittance into India in accordance with the Foreign Exchange Regulations Act and the Rules made thereunder which are applicable to the deduction under Section 80N apply as well to the deduction under this Section.

Deduction in respect of income of cooperative societies :

Under Section 80P the profits and gains of business carried on by a co-operative society and included in the gross total income of the society from the following type of business would be totally exempt from tax. The exemption is given by way of a deduction from the gross total income. The following items of income would be totally exempt from tax for all purposes of assessment without any monetary or other limits :

(i) income from the business of banking or providing credit facilities to its members ; or

(ii) income from a cottage industry ; or

(iii) income from the marketing of the agricultural produce of its members ; or

(iv) income derived from the purchase of agricultural implements, seeds, live-stock or other articles intended for agriculture or for the purpose of supplying them to its members ; or

(v) income from processing, without the aid of power, of the agricultural produce of its members ; or

(vi) income derived from supplying milk raised by the members to a federal milk co-operative society ;

(vii) the business income of labour co-operative societies as well as societies engaged in fishing and other allied pursuits, such as, catching, curing, processing, preserving, storing, and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members. However, the exemption in respect of this type of income will be available only in the case of those co-operative societies which, under their rules and bye laws, restrict the voting rights to members who constitute the labour force or who actually carry on the fishing or other allied activities.

Section 80P also provides that in the case of a co-operative society being a primary society engaged in supplying milk oilseeds, fruits or vegetables raised by its members to a federal milk co-operative society or the Government or a local authority or a Government company or a statutory corporation established by or under a Central, State or Provincial Act (being a company or corporation engaged in supplying such articles to the public) the *whole* of the amount of profits and gains of such business would be exempt from tax by way of deduction from the gross total income of the co-operative society.

2. Further, a co-operative society which is engaged in activities other than or in addition to those mentioned above, is not liable to pay any income-tax on the first Rs. 20,000 of its business income arising from other activities. Thus a co-operative society which is engaged in any business activity besides any of the business activities mentioned in clauses (i) to (iii) of item 1 above would not be liable to pay any income-tax on the whole of its income derived from any of the activities specified and also on the first Rs. 20,000 of its business income from activities other than those aforesaid However, with effect from 1-4-1980 consumers' co-operative societies would be entitled to a deduction of Rs. 40,000 from their gross total income as against Rs. 20,000 allowable in other cases.

The deduction in respect of business profits is not restricted to the profits from the business of the society with its members alone but is available in respect of profits from any business carried on by a co-operative society with non-members as well. The interest received by a co-operative society on deposits made from its circulating capital is deductible as being a part of the profits of its banking business. Interest on securities held by a co-operative society as the stock-in-trade of the banking business carried on by it is wholly deductible under 1 (i) above.

3. Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full from its gross total income.

4. Any income arising to a co-operative society, chargeable under the head 'interest on securities' (Section 18) or 'income from house property' (Section 22) is not chargeable to income-tax in cases where the total income of the co-operative society does not exceed Rs. 20,000 and it is not a housing society or an urban consumers' society or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

5. The income of a marketing society derived from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is totally exempt from tax.

6. Further, where the co-operative society is also entitled to the deductions available under Sections 80HH, 80HHA, 80HHB, 80HHC, 80I, 80J, 80JJ, and the deduction under this Section [i.e., 80P(1)] shall be allowed with reference to the total income as reduced by the deduction allowable respectively under Sections 80HH, 80HHA, 80HHB, 80HHC, 80I, 80J and 80JJ.

Deduction in respect of profits and gains from the business of publication of books : (80QQ).

Under section 80QQ, any person carrying on a business, in India, of the printing and publication of books or publication of books without the activity of printing, is entitled to a deduction, in the computation of his total income of an amount equal to 20% of the profits from such business included in his gross total income. The deduction is admissible for the assessment years 1971-72 to 1985-86.

The section makes it clear that the expression "books" in this context does not include newspapers, journals, magazines, diaries, brochures, tracts, pamphlets and other publications of a similar nature, by whatever name called.

Where the publisher is entitled to deductions under section 80HH, 80HHA, 80I, 80J, or 80P then section 80QQ is to apply only to the profits and gains of the publication business as reduced by the deductions under the said sections.

Deduction in respect of professional income of authors of text books in Indian languages (Section 80QQA)

Under Section 80QQA, authors of standard text books prescribed for a degree or Post Graduate Course of a University in any language specified in the Eighth Schedule to the Constitution of India or in any other language which the Central Government may notify, having regard to the need for promotion of publication of such text books in that language and other relevant factors, would be entitled to a deduction, in computing the total income of a sum equal to 25% of the income from such books included in the gross total income. The deduction is admissible for the assessment years 1980-81 to 1984-85 (both inclusive). In order to qualify for this deduction what is material is that the income must arise to the assessee during the previous year relevant to the aforesaid assessment years in accordance with the method of accounting followed by the tax-payer coupled with the further condition that the author must be an individual resident in India. The income derived by the assessee in exercise of his profession as author must be included in the total income of the relevant assessment year, it is however, immaterial whether such income represents any lumpsum consideration for the assignment or grant or any interest in the copyright of any book or of royalties or copyright fees receivable in lumpsum or otherwise in respect of the text book. The text book, the income from which qualifies for deduction, should be in nature of a dictionary, thesaurus or encyclopaedia or a text book prescribed or recommended by any University for a degree or Post Graduate Course. For this purpose the expression *'author'* must be taken to include the joint author. Any lumpsum amount receivable in regard to royalties or copyright fees must be taken to include an advance payment on account of such royalties or copyright fees if it is not refundable.

Remuneration received by an assessee from a foreign University etc. (Section 80R) ; According to this section Indian citizens receiving remuneration outside

India from any University or other educational institution or association or body established outside India and approved for this purpose for their services rendered outside India as a professor, teacher, research worker in such University, institution, association or body are entitled to a deduction of 50% of such remuneration received by them. But the question of deduction arises only where the income is otherwise taxable in India. Thus if the assessee is a non-resident individual, the deduction would not be available. This benefit, however, is available to the assessee for a maximum period of thirty six months, where he continues to render such a service outside India for more than 36 months no deduction is allowable in respect of the remuneration for the services rendered after the expiry of the first 36 months. The Finance Act 1983 has done away with the requirement of notification. Accordingly, the deduction in respect of remuneration from foreign sources in the case of professors, teachers etc. will now be available where such services are rendered not merely in any University or other educational institution but also to any other association of body without the necessity of it being notified. This will be effective from 84-85 assessment year onwards.

11. **Deduction in respect of professional income from foreign sources in certain cases (Section 80RR) :** This Section provides tax concession to individuals who are authors, playwrights, artists, musicians, actors or sportsmen (including athletes) who derive income from foreign sources.

The concession is given by allowing a deduction of an amount equal to 25% of the income derived from foreign sources from out of the gross amount of such income included in the assessee's total income. For this purpose it is immaterial whether the assessee is an Indian citizen or not. The conditions under which the relief is admissible are :

(i) The person must be a resident of India during the relevant previous. year.

(ii) The income is derived from foreign sources in exercise of a profession

(iii) The income is received in India or is brought to India in the shape of foreign exchange in accordance with the Foreign Exchange Regulations Act, 1973 and the Rules made thereunder.

Deduction in respect of remuneration for services rendered outside India : Section 80RRA provides that employees would be entitled to deduction from their gross total income in respect of remuneration received for services rendered outside India. According to this provision, any individual who is a citizen of India and who receives any remuneration in foreign currency from an employer for services rendered by him outside India would be entitled to claim a deduction from his gross total income in all cases where the amount of remuneration is included in the gross total income. The amount of deduction allowable under this Section shall be a sum equal to 50% of the amount of such remuneration due to or received by the employee. If the employee renders continuous service outside India for a period exceeding 36 months, no deduction would be allowable in respect of the remuneration for such services relating to any period after the expiry of the 36 months. In the case of an individual who is or was, immediately before undertaking

the foreign service in the employment of the Central Government, the deduction is allowable only if his services are sponsored by Central Government. In the case of any other individual the allowability of this deduction is subject to the condition *that the assessee is a technician and his contract of service under or with the foreign employer is approved for this purpose by the Central Government or the prescribed authority.*

The benefit of deduction under this provision would be available in every case regardless of the fact who the employer is Such an employer may be a foreign employer of an Indian concern, utilising the services of the Indian citizens, outside India, if the employer is a foreign employer', such foreign employer may be the Government of a foreign State or a foreign enterprise or any association or body established outside India.

The deduction of a sum equal to 50 per cent of the amount of remuneration received by individuals who are citizens of India would be allowed from their gross total income only if such remuneration is received in the foreign currency from any employer for services rendered outside India. If however the remuneration for services rendered outside India is received in Indian currency, the benefit of deduction would not be available, prior to this amendment the admissibility of the deduction was not in any way dependent on the receipt of the remuneration in foreign currency. If the remuneration is received partly in Indian currency and partly in foreign currency, the deduction would be allowable only with reference to that portion of the remuneration which is received in foreign currency The new amendment does not, however, make it clear as to the entitlement of the employee to claim deduction in cases where the remuneration is not received in foreign currency but continues to be remaining due to him from the foreign employer as a result of the payment not being actually made.

The term "*technician*" means a person having specialised knowledge and experience in—

(i) Constructional or manufacturing operations or in mining or in the generation and/or distribution of electricity or any other form of power: or (ii) agricultural, animal husbandry, dairy farming, deep-sea fishing or ship building or (iii) public administration or industrial or business management ; or (iv) accountancy ; (v) any field of natural or applied science (including medical science) or social science ; or (vi) any other field which the 'Central Board of Direct Taxes may prescribe in this behalf. In order to be eligible for the tax concession, it is essential that the technician must be employed in a capacity in which his specialised knowledge and experience in respect of the field of his specialisation are actually utilised in the course of his rendering services outside India.

Deduction in respect of compensation for termination of managing agency etc. in the case of assessees other than companies : (80S)

An assessee is entitled under this section to a deduction from his gross total income in respect of the compensation for termination of managing agency and other income chargeable to tax under sub-clauses (a), (b) and (c) of clause (ii) of **Section 28(ii). The conditions of this deduction are as under ;**

(i) **The person** should be an assessee (other than a company) resident in India.

(ii) The compensation or other income included in the gross total income must be chargeable to tax as income from business under section 28(ii) of the Act.

(iii) The person should be managing the whole or substantially the whole of the affairs of an Indian company or any other company in India.

(iv) The person should be holding an agency in India for any part of the activities relating to the business of any other person.

(v) The compensation or other income should have been received at or in connection with the termination of the agency or the modification of terms and conditions relating thereto.

The amount of deduction shall be a sum equal to 25% of the amount of compensation or other income included in the gross total income or Rs. 1,00,000 whichever is less. It is to be noted that the compensation received by an assessee in respect of the vesting in the Government of the management of the business of the industrial undertaking, etc., which was taken over by the Government would *not* qualify for the deduction from gross total income although it is taxable as income from business like the compensation for termination of managing agency of any other agency.

Deduction in respect of Long-term capital gains (LTCG) in the case of assessees other than companies : (80T)

Section 80T provides for an allowance of a straight deduction, in the computation of the total income of non-company assessees, in respect of long term capital gains included in their gross total income.

Position from assessment year 1983-84

As a result of the amendment of section 80T and the insertion of the Twelfth Schedule by the Finance Act, 1982 with effect from 1-4-1983 the position will be as follows :

Where the LTCG do not exceed Rs. 5,000 the whole of such long-term capital gains will be allowed as a deduction.

Thereafter the deduction is to be based on the number of years for which the relevant long-term capital assets have been held by the assessee. For this purpose a two-fold classification has been maintained and the rate of deduction is as follows :

Period (in years) of holding of the capital assets	Rate of deduction in respect of LTCG relating to buildings or lands	Rate of deduction of LTCG relating to other capital assets
Not less than 3 but not exceeding 5	25%	40%
,, 5 ,, 10	28%	45%
,, 10 ,, 15	33%	50%
,, 15 ,, 20	37%	55%
over 20 years	40%	60%

Where the LTCG relate to gold, bullion or jewellery, the maximum deduction admissible under section 80T is to be restricted to Rs. 50,000.

Where the assessee has LTCG relating to land and buildings and also other assets.

In this case the initial deduction of Rs. 5,000 is to be given first in respect of LTCG relating to land and buildings and if such LTCG are less than 5,000, the balance is to be adjusted against LTCG relating to gold-bullion or jewellery and the balance, if any, against LTCG relating to any other capital assets.

Deduction in respect of winnings from lottery : (Section 80TT)

In computing the taxable income of all non-corporate assessees where the lottery winnings do not exceed Rs. 5,000, the whole of such winnings will be allowed as a deduction. In other cases, the deduction allowable to the assessee would be a sum equal to Rs. 5,000 plus 50% of the balance of the income by way of lottery winnings.

Deduction in the case of totally blind or physically handicapped resident persons (80U)

Totally blind individuals resident in India are allowed a straight deduction of Rs. 10,000 in computing their taxable income every year. A similar benefit is also available to individuals who are subject of or, suffering from a permanent physical disability (other than blindness which has the effect of reducing substantially his capacity to engage in gainful employment or occupation. It should be a permanent physical disability specified in the rules made in this behalf by the Board. However, in order to be eligible for the aforesaid deduction of Rs. 10,000 the assessee must furnish in respect of the first assessment year for which the deduction is claimed in the case of total blindness a certificate, from a registered aculist and

in the case of any permanent physical disability stated above, certificate from a registered medical practitioner. For subsequent assessment years such a certificate need not be produced.

Rebates and Reliefs

Section 86 (iii) provides that a partner of an unregistered firm (not being an unregistered firm assessed as a registered firm) is exempted from tax on his share income derived as a partner of an unregistered firm computed in accordance with provisions of Section 67 of the Act, and on which Income-tax is payable by the firm. If the firm is not chargeable to tax the partner will not be entitled to the rebate under this section.

Similar exemption is provided under clause (v) of Section 86 for a member of an association of persons or a body of individuals (other than a H.U.F., a company or a registered firm) in respect of any portion of the amount receivable by him from the association or body and on which tax has already been paid by the association or body. For this purpose, in the case of an association of persons which is assessable under the new Section 167A, the members of the association whose shares in the income or part of the income of the association of persons are indeterminate or unknown will be deemed to be entitled to receive equal shares in the total income or the part of the total income of the association and the individual shares of such member in the total tncome or part of the total income will be deemed accordingly. The amount so ascertained will be included in the assessment of the members of the association for rate purposes. For this purpose the shares of the members of the association will be regarded as indeterminate or unknown, if such shares are not ascertainable at the time of the formation of the association or at any time of the formation of the association or at any time thereafter.

Similarly, Section 86A provides that where interest on any securities either of the Central Government or that of the State Government issued are declared to be income-tax free, is included in that total income, the assessee is entitled to a deduction from the amount of the tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated on the amount included on account of interest on securities at the average rate of income-tax or at the rate of 27½% whichever is less. It is to be noted that the above items of receipt are includible in the total income of the assessee for ascertaining the average rate of tax applicable to him.

While discussing the provisions relating to Salaries and Interest on Securities we have already noted that Section 89 provides for relief when salary etc., is paid in arrears in advance or when interest on securities is received in arrears. In such cases, the I.T.O. has been empowered to grant relief, on an application made by the assessee in accordance with Rules 21A and 21B of the Income-tax Rules.

Miscellaneous Points

1.3. **Rates of tax applicable to individuals**: The rates of income-tax applicable to individual and other assessees like HUFs other than those having one or more members with independent taxable income, unregistered firms or other

association of persons or body of individuals, or artificial juridical persons, are specified in Paragraph A of part I of First Schedule to the Finance Act, 1984. The rates of tax applicable to individuals are progressive in nature *i e.* the rates increase with an increase in income at the appropriate slab and are exactly opposite to those applicable to companies which are subject to a flat rate of tax.

Accordingly, for the purposes of computing the tax payable for the assessment year 1984-85, the following rates of tax will have to be applied ;

Income	*Rates of tax*
Where the total income does not exceed Rs. 15,000	Nil
Where the total income exceeds Rs. 15,000 but does not exceed Rs. 20,000	25 per cent of the amount by which the total income exceeds Rs. 15,000 ;
Where the total income income exceeds Rs. 20,000 but does not exceed Rs. Rs. 25,000	Rs. 1250 plus 30 per cent of the amount by which the total income exceeds Rs. 20,000.
Where the total income exceeds Rs. 25,000 but does not exceed Rs. 30,000	Rs. 2750 plus 35 per cent of the amount by which the total income exceeds Rs. 25,000 ;
Where the total income exceeds Rs. 30,000 but does not exceed Rs 50,000	Rs. 4,500 plus 40 per cent of the amount by which the total income exceeds Rs 30,000 ;
Where the total income exceeds Rs. 50,000 but does not exceed Rs. 60,000	Rs. 12,500 plus 50 per cent of the amount by which the total income exceeds Rs. 50,000 ;
Where the total income exceeds Rs. 60,000 but does not exceed Rs. 70,000	Rs. 17,500 plus 52.5% of the amount by which the total income exceeds Rs. 60,000.
Where the total income exceeds Rs. 70,000 but does not exceed Rs. 85,000	Rs. 22,750 plus 55 per cent of the amount by which total income exceeds Rs. 70,000
Where the total income exceeds Rs. 85,000 but does not exceed Rs. 1,00,000	Rs. 31,000 plus 57.5 per cent of the amount by which the total income exceeds Rs. 85,000
Where the total income exceeds Rs. 1,00,000	Rs. 39,625 plus 60 per cent of the amount by which the total income exceeds Rs. 1,00.000.

1.4. **Surcharge on income-tax** : The amount of income-tax calculated on the total income [including the net agriculture income wherever includible for rate purposes] at the rates applicable to the assessee has to be increased by a surcharge for purposes of the Union at the rate of 12½% of such income-tax in the case of assessees who are individuals, H.U.F., unregistered firms, other associations of

persons or bodies of individuals, whether incorporated or not, local authorities and artificial juridical persons.

Part III of the First Schedule to the Finance Act 1984 has prescribed rates for the purposes of deduction of tax at source from salaries, advance tax payment, and assessment in certain special cases for the financial year 1984-85 (assessment year 1985-86) The following changes have been effected from the rate schedule applicable to assessment year 1984-85.

Slabs

	1984-85	*Rates*		*1985-86*	*Rates*
Upto	15,000-	Nil	Upto	15,000	Nil
	15,001-20,000	25%		15 001-20,000	20%
	20 001-25,000	30%		20,001-25,000	25%
	25,001-30 000	35%		25,001-30,000	30%
	30,001-50,000	40%		30,001-40,000	35%
	50,001 60 000	50%		40,001-50,000	40%
	60,001 70,000	52 5%		50,001-70,000	45%
	70,001-85,000	55%		70,001-1,00,000	50%
	85,001-1,00,000	57 5%		over 1,00,000	55%
Over	1,00,000	60%			

The rate of surcharge @ 12 5% remains the same.

It must be noted that an individual is liable to pay tax in respect of the following incomes :

(1) incomes earned by the individual himself ;

(2) share of income from a firm ;

(3) share of income from an association of persons ;

(4) income of other persons included in his income under Sections 60 to 65.

The following incomes are, however, included in the total income of an individual for rate-purposes only ;

(1) interest from tax-free government securities :

(2) profit from unregistered firm assessed as such ;

(3) income from an association of persons.

Practical Problems : Students should refer to the prescribed text books in order to work out independently the practical problems given therein. Students should realise that the subject of income-tax Law can be mastered only by constant practice of solving different types of practical problems involving application of the provisions of law to different types of situations. Students should also make it a point to attempt sincerely and seriously the problems given in the test papers supplied by the Board of Studies from time to time.

Self-Examination Questions—I—Capital Gains

State the correct position in each of the following cases :

1. State whether the following statements are correct or wrong.
   (a) Only property connected with the business of a person can be treated as capital asset under the Income-tax Act.
   (b) Agricultural land, wherever situated, will be treated as capital asset
   (c) A motor car used for personal purposes will not be a 'capital asset' within the meaning of Section 2 (14).
   (d) A capital asset held by an assessee for less than 36 months before the date of its transfer is treated as 'short-term capital asset'.
   (e) Short-term capital gains are taxed at concessional rates of tax.
2. The term 'transfer' in relation to a capital asset is defined in Section
   (a) 2 (1) (b) 2 (17) (c) 2 (47) (d) 2 (22A), (e) 47. ( )
3. Certain transactions are not deemed to be 'transfers' for purposes of capital gains tax though in law they amount to transfer. These are specified in Section (a) 47 (b) 49 (c) 2 (47) (d) 2 (19) (e) 45. ( )
4. An assessee will be exempt from liability to capital gains tax if—
   (i) the income from the capital asset is chargeable to tax under the head (a) income from other sources (b) income from house property (c) capital gains (d) profits and gains of business or profession.
   (ii) the total value of the consideration received on sale of the property does not exceed, and
   (iii) the aggregate of the fair market value of all such assets owned by the assessee immediately prior to the transfer does not exceed— (a) Rs. 50,000 (b) Rs. 30,000 (c) Rs. 25,000 (d) Rs. 72,000. ( )
5. Capital gains on sale of house property would be exempt from tax if the house is (a) let-out (b) occupied by the owner for his own or his parents residence (c) partly let-out and partly occupied by the owner himself (d) leased out for 30 years.
6. In order to get exemption from liability to capital gains tax the assessee must (i) construct within—or (ii) purchase within—a residential house (a) one year (b) two years (c) 8 years.
7. Transfer of agricultural land in any part of India would not be treated as a transfer of capital asset if it was effected (a) after 1-3-1970 (b) before 1-3-1970 (c) after 1-4-1971 (d) on or before 31-3-1972.
8. Capital gains arising from the sale of jewellery would be exempt from tax in cases where (a) the whole of the capital is reinvested (b) the whole of the net value of the consideration is reinvested as per Section 54E (c) 50% of the sale proceeds are reinvested in the acquisition of new jewellery for personal use.

9. The cost of acquisition of a capital asset in cases where the capital asset became the property of the assessee as a result of succession, inheritance, devolution, *etc.*, and the asset was acquired by the previous owner prior to 1964 should be ascertained with reference to its market value on (a) 1-4-1961 (b) 1-4-1970 (c) 1-4-1954 (d) 1-1-1964 (e) 1-4-1955. ( )

10. Concessional tax treatment is available in respect of (a) short term capital gains (b) long-term capital gains (c) professional income (d) salary income (e) business income (f) dividends and interest.

11. Where a capital asset became the property of the assessee under a gift, the cost of acquisition shall be (a) Rs. 5000 (b) the cost for which the previous owner of the property acquired it as increased by the cost of any improvement to the asset incurred or borne by the previous owner or the assessee, as the case may be (c) the cost for which the previous owner acquired it less depreciation @ 10% p.a.

12. In cases where the Income-tax Officer is not satisfied as to the correctness of the value of a capital asset, he can refer the valuation to (a) Chairman of CBDT (b) Finance Minister (c) Valuation Officer (d) Commissioner of Income-tax.

13. In cases where an asset is valued by a Registered valuer the I.T.O. can refer the valuation to the Valuation Officer if he is of the opinion (a) that the value so claimed is less than its fair market value, (b) that the value so claimed is less than Rs 50,000 (c) that the value of the asset exceeds Rs. 35,000.

14. If the fair market value of an asset is Rs. 50,000 and the value as claimed by the assessee is Rs. 30,000, I T O. (a) can (b) cannot refer the valuation to the Valuation Officer.

15. Before taking action under Section 52, the I.T.O. has to get the prior approval of (a) I.A.C. (b) Commissioner (c) Chairman of the CBDT.

Self-Examination Questions—II—Income from other Sources, Set-off and Carry forward of Losses

State the correct position in each of the following cases :

1. Examinership fees received by X, Professor of Physics, Delhi University from the Madras University as a result of his position as the Professor of Physics to be shown in his income-tax return as (a) income from salaries (b) income from other sources (c) income from profession (d) capital gains.

2. Income from lotteries, horse races, betting and gambling received by a person who is regularly receiving these incomes and is engaged in these activities as his vocation should be taxed as his income from (a) salaries (b) business (c) capital gains (d) other sources (e) house

3. Dividends from shares held as stock in trade of the assessee's business should be included in his total income as (a) income from business (b) interest on securities (c) income from profession (d) income from other sources.

4. A loss under one head of income can generally be set off against income under any other head in the same year except in cases where the loss is from (a) profession (b) speculation business (c) short-term capital asset (d) long-term capital asset (e) other sources (f) business.

5. The time limits for carry forward of unabsorbed (i) business losses (including speculation losses) (ii) short-term capital loss (iii) depreciation (iv) long-term capital loss (v) investment allowance (vi) expenditure on scientific research are (a) no time limit (b) cannot be carried forward (c) 4 years (d) 8 years (e) 6 years (f) 5 years

( ) ( ) ( ) ( ) ( )

6. A brought-forward business loss can be set-off against (a) salary income (b) dividends from shares and interest on securities which are held as stock in-trade of business (c) income from lotteries (d) capital gains.

( )

7. A business loss cannot be carried forward after the business (a) has ceased to be carried on by the assessee (b) has been amalgamated (c) has been succeeded by the legal heirs. ( )

8. A loss can generally be determined under the head 'income from house property'. Such a loss (a) cannot be set off against other income in the same year (b) can be carried forward being set off against rental income from house property in the next 8 years (c) can be set off against income under any other head in the same year (d) cannot be determined as a result of allowance for newly built residential house and unoccupied residential house.

9. Losses incurred by an individual in gambling could be set off against his income from (a) salaries (b) speculation business (c) capital gains (d) gambling (e) betting (f) lotteries.

10. Losses in lotteries, betting and gambling would, to the extent they cannot be set off in the same year, be (a) carried forward for 8 years (b) carried forward for four years and set off against income from race horses (c) carried forward indefinitely and set off against income from the same sources (d) lost once and for all since there is no right of carry-forward except in the case of losses in races.

Self-Examination Questions—III—Clubbing of income

1. Cases of transfer of income without transfer of assets are covered by Section (a) 60 (b) 64 (c) 63 (d) 27. ( )

2. Revocable transfer of assets is covered by Section (s)
(a) 60 to 63 (b) 60 (c) 64 (d) 27. ( )

3. Section 64 (1) (*i*) is applicable to a firm in which both the individual and the (a) spouse (b) sister (c) father (d) major son of such individual are partners. ( )

4. The provisions of Sections 64 (1) (i) are not applicable to a firm carrying on (a) business (b) business in textiles (c) profession (d) speculation business. ( )

5. Where both the individual and spouse are *partners in* the same firm, the income of the spouse must be added to that of the (a) husband (b) wife (c) husband or wife whose total income, excluding the income from the firm, is greater.

6. The share income of the minor child admitted to the benefits of a partnership should be included in the income of (a) mother (b) father (c) that parent whose total income excluding the minor's income from the firm is greater. ( )

7. Section 64 (2) applies to conversions effected after

   (a) 31st December, 1969 (b) 30th March, 1970 (c) 30th April, 1971. ( )

8. In cases of a conversion falling under Section 64 (2) the amount that will be included in the individual's income is (a) Rs. 5,000 (b) the entire income from the converted property (c) the income from the converted property proportionate to the share of the individual his spouse and minor son.

9. By making a partition immediately after conversion one can escape from the rigours of Section 64 (2) completely — This statements is (a) true (b) false.

10. Gift of property by an individual to his Hindu undivided family would be outside the scope of Section 64(2) — This statement is (a) wrong (b) correct.

Self-Examination Questions—IV—Deductions

State the correct position in each of the following cases :

1. The deduction available under Section 80HH to new industrial undertakings and hotels in backward areas is to the extent of

   (a) Rs. 2,00,000 (b) Rs. 10,000 (c) Rs. 50,000 (d) 20% of such profits and gains included in the gross total income.

2. In order to qualify for the exemption under Section 80HH the assessee should have commenced the business at any time after :

   (a) 31-3-1973 (b) 31-1-1971 (c) 31-12-1966 (d) 30-9-1971 ( )

3. The exemption under Section 80HH is available for a total period of :

   (a) 8 years (b) 5 years (c) 10 years. ( )

4. Tax holiday benefit under Section 80I is available to assessees for a total period of :

   (i) for co-operative societies (ii) for other assessees. (a) 6 years (b) 10 years (c) 8 years (d) 7 years. ( )

5. The value of the tax-holiday concession under Sec. 80I is calculated at a percentage of profits and gains from in the undertaking included in the Gross Total Income the percentage being :

(i) in case of companies (ii) in case of non-corporate assessees. (a) 20% (b) 15% (c) 25% (d) 30%,

6. The deduction with effect from the assessment year 1984-85 in respect of dividends, *etc*, under Section 80L is available for a sum of—(a) Rs. 7,000 (b) Rs. 1,000 (c) Rs. 5,000 (d) Rs. 4,000. ( )

7. Remuneration from foreign sources received by an individual as professor, teacher, *etc*, qualifies for deduction from gross total income at the rate of (a) 40% (b) 60% (c) 25% (d) 100% (e) 50% ( )

8. The income from foreign universities *etc.*, will cease to qualify for deduction in respect of the income of the period of service rendered abroad after the expiry o the first—months (a)24(b)36(c)12 (d) 48 (e)60.

9. Professional income from foreign sources qualifies for deduction from gross total incom. at the rate of—(a) 33-1/3% (b) 60% (c) 25% (d) 80%

10. The amount of compensation for termination of managing or other agency qualifies for deduction from gross total income (i) in the hands of (a) all assessees (b) resident individuals (c) domestic companies (d) firms (e) all non corporate assessees.

(i) at the rate of (a) 50% (b) 100% (c) 25% (d) 33⅓% (e) 66⅔%. ( )

11. The maximum amount deduction under Section 80-S is a sum of equal to a certain percentage of the actual amount of compensation. However, deduction allowable in any case shall not exceed (a) Rs. 500,000 (b) Rs. 1,00,0 0 (c) Rs 2,00,000 (d) 10,000.

12. Long-term capital gains qualify for deduction from gross total income in the hands of (a) all assessees (b) all companies (c) Indian companies (d) all non-corporate assessees (e) all resident Indian citizens. ( )

13. Long term capital gains attributable to (i) land & buildings and (ii) other assets held for four years qualify for deduction of the first Rs. 5,000 *plus* . of the balance. (a) 65% (b) 45% (c) 25% (d) 40% (e) 30%.

14. Long-term capital gains which are less than Rs. 5,000 are not taxable in all cases. This statement is (a) correct (b) wrong ( )

15. Blind and physically handicapped individuals qualify for exemption from tax by way of deduction from their gross total income only if they are (a) resident in India (b) citizens of India (c) resident Indian citizens (d) non-resident Indian citizens (e) non-residents. ( )

16. The amount of deduction from gross total income available to blind and permanently disabled individual is—

(a) Rs. 10,000 (b) Rs. 20,000 (c) Rs. 2,000 (d) Rs. 10,000 (e) Rs. 12,500. ( )

17. In the case of blind persons, the benefit of deduction will be available only if the assessee produces a certificate from registered medical practitioner who should be

(a) a dentist (b) an oculist (c) a skin specialist (d) a surgeon. ( )

18. Deductions from gross total income is available in respect of profits from the business of publication of books from the assessment year 1971-72. This deduction is (1) available to

(a) all assessees (b) all Indian citizens (c) all non-corporate resident assessees (d) all companies,

(ii) of an amount equal to—of the profits from the business of publication.

(a) 33% (b) 25% (c) 20% (d) 50% (e) 80% ( )

19. Saving through life insurance premia, provident fund, *etc.* qualify for deduction from gross total income in the hands of--

(a) all individuals and H.U.Fs (b) all individuals being citizens and residents of India (c) all companies (d) all partners of firms.

20. The qualifying amount of life insurance premium should not exceed ....of the capital sum assured (a) 25% (b) 30% (c) 100% (d) 10% (e) 50%.

21. Contributions by an employee to a recognised provident fund will not qualify for deduction in excess of......the salary.

(a) 20% (b) 12½% (c) 8⅓% (d) 6% (e) 25% (f) 30%. ( )

22. With effect from the assessment year 1984-85 the overall amount of saving qualifyings for deduction from gross total income under Sec. 80C shall not exceed (a) Rs. 25,000 (b) Rs. 30,000 (c) Rs. 40,000 (d) Rs. 50,000.

23. In the case of authors, playwrights, artists, musicians and actors the overall limit of the qualifying amount under Sec. 80C with effect from the assessment year 1984-85 is (a) Rs. 30,000 (b) Rs. 40,000 (c) Rs 60,000 (d) Rs. 5,000. ( )

24. National Savings Certificates Issues (vi) and (vii) are notified by the Government for the purposes of Sec. 80C. This statement is (a) correct (b) incorrect. ( )

25. The deduction allowable for the medical treatment of a dependent relative is admissible in the case of (a) all individuals (b) all individuals who are Indian citizens (c) Individuals and H.U.Fs. resi. in India ( )

26. The amount of deduction is

(i) If the dependent relative had been treated for more than 182 days in an approved institution (ii) in other cases.

(a) Rs. 1,800 (b) Rs. 1,200 (c) Rs. 4,800. ( )

27. Payments made by an assessee to secure retirement annuities quality for deduction from gross total income in cases where the assessee is (a) a partner of an unregistered firm (b) a partner of a registered business firm (c) a member of a H U.F. (d) a partner of a registered professional firm. ( )

28. The deduction under Section 80L is available only if the assessee is (a) an individual, H.U.F. and certain A.O.P. (b) a member of the professional body from which he has qualified (c) a non-Indian [illegible] India (a) a coparcener of a H U F

29. The monetary limit under Section 80E for deductions of the premia paid by the assessee is (a) Rs. 10,000 (b) Rs. 12,500 (c) Rs. 5,000 (d) Rs. 20,000. ( )

30. The deduction on account of premia paid to secure retirement annuities shall not exceed.. .. of the gross total income. ( )
(a) 30% (b) 10% (c) 25% (d) 15% (e) 33⅓ ( )

31. Expenses incurred by the assessee on the education of his children outside India qualify for deduction form the gross total income if the assessee is

(a) resident individual and citizen of India (b) a resident individual and non-Indian citizen (c) a member of a resident H.U.F. (d) a non-resident Indian citizen ( )

32. Deduction on account of the expenses incurred by an assessee who is a non-Indian citizen a resident in India, on eduction of his children out side India is allowed in the case of (i) one child- (a) Rs. 3,000 (b) Rs. 2,500 (c) Rs. 1,500 (ii) more than one child (a) Rs. 5,000 (b) Rs. 3,000 (c) Rs. 400.

33. Donation made by all assessees to entites for purposes (other than Family Planning) mentioned in Section 80G qualify for deduction from gross total income at the rate of.

(a) 50% (b) 55% (c) 30% (d) 60% (e) 80% ( )

34. The maximum amount of donations for charitable purposes qualifying for reduction from from gross total income shall not exceed...of the gross total income as reduced by any other deduction under chapter VIA
(a) 30% (b) 20% (c) 10% (d) 50% (e) 60%. ( )

35. In order to qualify for deduction the aggregate of donations should not be less than :
(a) Rs. 500 (b) Rs. 250 (c) Rs. 1,000 (d) Rs. 5,000 (e) 3,000. ( )

Answers to Self-Examination Questions—I

1. [a] Wrong [b] Wrong [c] Right [d] Right [e] Wrong. 2. [c]. 3. [a] 4. [i] [b], [ii] [c], [iii] [a]. 5. [b] 6. [i] [c], [ii] [a]. 7. [a]. 8. [b] 9. [d] 10. [b], 11. [b], 12. [c], 13. [a], 14. [a], 15. [a].

Answers to Self-Examination Questions—II

1. [b], 2. [d], 3. [d], 4. [b], 5. [i] [d], [ii] [d], [iii] [a], [iv], [c] [v], [d], [vi], [a], 6. [b], 7. [a], 8. [c] and [d] 9. [d], 10. [d].

Answers to Self-Examinations—III

1. [a], 2. [a], 3. [a], 4. [c], 5. [c], 6. [c], 7. [a], 8. [b], 9. [b], 10. [a].

Answers to Self-Examinations—IV

1. [d], 2. [a], 3 [c] 4. [i] [b], [ii] [c], 5. [i] [c], [ii] [a], 6. [a], 7. [e], 8. [b], 9. [c], 10. [i] [e], [ii] [c], 11. [b] 12. [d], 13. [i] [c], [ii] [d], 14. [b], 15. [a], 16. [d], 17. [b] 18 [i] [a], [ii] [c], 19. [a], 20. [d], 21. [a], 22. [c], 23. [c], 24. [a], 25. [c], 26. [i] [c] [ii] [d], 27. [d], 28. [a], 29. [c], 30. [b], 31. [b], 32. [i] [c], [ii] [b], 33. [a], 34. [c], 35. [b].

APPENDIX

Deductions from Gross Total Income : A bird's eye view

Section	Persons entitled for deduction	Nature of payment/income that qualifies for deduction	Limits of Qualifying Amount and/or Rate(s) of deduction	Remarks
1	2	3	4	5
Sec. 80C	Individuals, H.U.F.s and Association of persons or Body of Individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadar and Nagar Haveli and Goa, Daman & Diu.	Payments made out of chargeable income during the previous year such as: (i) premium paid on insurance policy taken on the life of assessee/his spouse children or members of HUF as the case may be (ii) contribution to Statutory Provident Fund. (iii) Deduction from a Government's employee's salary for securing a deferred annuity. (iv) Premium paid for securing non-commutable deferred annuity. (v) Contribution to a Recognised Provident Fund of Superannuation Fund (vi) Deposits in 10 year or 15 year account under the Post-office Savings Bank (Cumulative Time (Deposits) Rules 1959.	Qualifying amount of an individual being an author, playwright, artist, musician, actor, sportsman (including an athlete) shall be limited to Rs. 60,000. (i) In case of all other persons, qualifying amount shall be limited to Rs. 40,000. Rates of deduction of qualifying amount shall be—100% of First Rs. 6,000; 50% of next Rs. 6,000 : and 40% of Balance.	If the assessee terminates an insurance policy during the previous year before payment of premium for two years, then no deduction shall be allowed in respect of premiums paid during that year and the deduction allowed in respect of premiums paid during the earlier previous year shall be deemed to be the income of such earlier previous year.

1	2	3	4	5
		(vii) Contribution for participation in the Unit Link Insurance Plan. (viii) Contribution to Public Provident Fund. (ix) Subscription to any notified Central Government Security (National Savings Certificates Issues VI and VII)		
Sec. 80CC	do	Payments made during the previous year and within six months from the end of such previous year towards cost of shares of 'eligible issue of capital' acquired during the previous year.	Qualifying amount shall be limited to Rs. 20,000. Deduction shall be at the rate of 50% of qualifying amount.	If the shares in respect of which deduction is claimed, are sold or otherwise transferred by the assessee within a period of 5 years from the date of acquisition then deduction already allowed shall be deemed to be the income of the assessee of the previous year in which they were so sold or transferred. No deduction is available with reference to the cost of any shares offered for public subscription after 31.3.1987.
'ec. 0D	Individuals and HUFs who are resident in India	Expenditure incurred on medical treatment of handicapped dependent relatives of individual or members of HUF, out of chargeable income during the previous year.	The deduction shall be (i) Rs. 4,800 per each handicapped relative who is hospitalised for 182 days or more and (ii) Rs. 1,200 in case of each of other handicapped relatives.	Deduction will not be available for the assessment year 1985-86 and onwards.

1	2	3	4	5
Sec. 80E	**Individuals being citizens of India and residents in India and partners in a registered firm.**	Premiums, paid under an approved annuity contract with the main object of providing a life annuity for individual (aged between 28 and 68) or for the individual's widower or any premium paid to an approved annuity fund.	The amount of deduction is restricted to Rs. 5,000 or 10% of G.T.I. whichever is less.	No deduction in respect of amount paid after 29.2.1984.
Sec. 80F	Individuals who are not citizens of India but are residents in India.	Any sum spent out of chargeable income on the education of his children who are dependent on him for maintenance and who are not more than 21 years of age. The education must be pursued at a University, College, School or other educational institution situated outside India.	The amount of deduction is Rs. 1,500 in case of an individual having one child and to Rs. 3000 in the case of an individual who has more than one child.	
Sec. 80.G	All assessees.	Any sum paid by the assessee during the previous year to (i) National Defence Fund (ii) Jawaharlal Nehru Memorial Fund. (iii) The Prime Minister's National Relief Fund (iv) The National Children Fund, (v) The government or local authority to be utilised for any charitable purpose other than the	No limit of qualifying amount in respect of donations made to Funds referred to (i) to (iv) in Column 3. In respect of others, the qualifying amount shall be limited to lower of (i) Rs. 5,00,000 and (ii) 10% of Gross Total Income as reduced by deductions available under other sections of Chapter VIA. The rate	No deduction is available if aggregate of all donations referred to in column 3 does not exceed Rs. 250. Only donations made in cash shall qualify for deduction.

1	2	3	4	5
		Family Planning. (v) The Housing Boards or Statutory Authorities referred to in Sec. 10(20A) (vii) The Government or to any local authority or institution or association approved by the Central Government, to be utilsed for the purpose of promotion of Family Planning. (viii) For the renovation of notified temples, gurudwara, mosques etc.	of deduction shall be 100% of qualifying donations referred to in item (v) of Column 3 forming part of qualifying amount and or 5% of other qualifying amount.	
Sec. 80GG	Assessees who are not in receipt of House Rent Allowance.	House rent paid in respect of residential accommodation occupied by the assessee in excess of 10% of total income as arrived at before allowing deduction under this Section.	Deduction shall be restricted to 15% of Total Income not exceeding Rs. 400 per month.	The assessee himself or his spouse or HUF of which he is a member should not own accommodation at a place of residence or where he is employed etc. And the assessee should not have owned any accommodation at any place in respect of which self-occupation allowance is permitted under Sec. 23 (2).
Sec. 80GGA	All assessees.	Payments made to approved scientific research associations or approved rural development associations etc.	Actual sum paid shall be entitled for deduction.	—

1	2	3	4	5
Sec. 80HH	All assessees.	Profits and gains from a new industrial undertaking in a notified backward area included in the assessee's gross total income.	The quantum of deduction shall be 20% of such profits and gains.	The tax concession is available for 10 initial assessment years,
Sec. 80HHA	All assessees.	Profits and gains from a new small scale industrial undertaking included in the assessee's gross total income.	—do—	—do—
Sec. 80HHB	Indian companies and Resident assessees.	Profits and gains derived from the execution of a foreign project undertaken by the assessee or any work forming part of a "foreign project" undertaken by any other person.	25% of the eligible profit and gains or the lesser of the amount credited to Foreign Project Reserve Account or the amount actually brought into India by the assessee.	There are conditions as audit, crediting of 25% of eligible profits and gains to Foreign Projects Reserve Account and bringing such amount into India.
Sec. 80HHC	Indian companies and resident assessees.	Export turnover.	1% of Export turnover during the first previous year 5% of the excess of export turnover over that of the preceding previous year.	Deduction not applicable to agricultural primary commodities not being produce of plantations mineral oil; minerals and ores.
Sec. 80-I	All assessees.	Profits and gains from a new small scale industrial undertaking manufacturing any item or any other new industrial undertaking manufacturing any item other than an item notified in the eleventh schedule. Profits and gains from a ship or hotel or from the business of repairs to ocean going	In case of non-corporate assessees the quantum of deduction shall be 20% of profits and gains referred to in column (3) In case of corporate assessees, the rate of deduction shall be 25% of such profits and gains. The deduction is with reference to such profits and gains included in the assessee's gross	The concession is available for 10 initial assessment year in case of corporative societies and for 8 initial assessment years in case of other assessees. If deduction is claimed and allowed under Sec. 80HH or 80HHA in respect of such profits and gains, then deduction

1	2	3	3	4
		vessels also qualify for deduction in certain cases. Such new industrial undertakings etc. must have begun their operation on or after 1st April 1981.	total income.	under this section shall be with reference to such profits and gains as reduced by deduction allowed under Sec. 80HH or 80HHA.
Sec. 80J	All assessees.	Profits and gains from new industrial undertakings manufacturing an item not specified in the eleventh schedule. Profits and gains from a ship or a hotel also qualify in certain cases. The industrial undertaking etc. must have come into operation on or before 31st March, 1981.	Profits and gains from such undertakings etc. included in Gross Total income subject to a of deduction shall be maximum of 6% (in case of non-corporate assessees) or 7½% (in case of corporate asssessees) of capital employed.	The concession is available for 7 initial assessment years in case of co-operative societies. and for 5 years in case of other asssessees. If deduction is claimed and allowed under Sec. 80HH or 80HHA in respect of such profits and gains, deduction under this Section shall be with reference to such profits and gains as reduced by deduction allowed under Sec. 80HH or 80HHA.
Sec. 80JJ	All assesseees.	Profits and gains from business of livestock breeding or poultry or dairy farming included in the assessee's gross total income.	Quantum of deduction in case where such profits and gains do not exceed Rs. 15,000 the whole of such profits and gains. In case where such profits and gains exceed Rs. 15,000 then 15% of such profits and gains or Rs. 15,000 whichever is greater.	Profits and gains from the business of poultry farming in excess of Rs. 1,00,000 shall be ignored while computing deduction.

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Sec. 80L	Individual, **HUFs and Associations of Persons** or Bodies of **Individuals consisting only of husband and wife governed by the system of community in force in the Union territories of Dadra and Nagar Haveli and Goa, Daman and Diu.**	Income by way of (i) interest on the Central Govt. or State Govt. Securities *e g.* interest on NSC. (ii) Interest on debentures issued by certain notified co-op. societies. (iia) Interest on National Deposit Scheme investments. (iii) Interest on certain deposits notified by the Central Government.	The quantum of deduction shall be income referred to in column 3 included in the assessee's Gross Total Income subject to a maximum of Rs. 7,000. In addition to this (I) Rs. 3,000 for income from units and National Deposit Scheme investment (ii) Rs. 3,000 for income from National Deposit Scheme investments.	—
		(iv) Dividends from Indian companies. (v) Income from units of UTI. (vi) Interest on deposits with Scheduled Banks or Co-operative Societies engaged in banking. (vii) Interest on deposits with certain other notified banks. (viii) Interests on deposits with financial corporations engaged in provision of long-term finance. with the Housing Development Boards etc. (ix) Interest on deposits (x) Interest and Dividends from co-opertive societies.		

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Sec. 80M	Indian companies and those foreign companies which have made prescribed arrangements for declaration of dividends in India, (Domestic Companies).	Income by way of dividends received from any domestic company and included in gross total income.	Quantum of deduction shall be 60% of such dividends included in the assessee's G.T.I. In cases whole the dividends are from such domestic companies which are exclusively involved in the manufacture of certain priority items, the rate of deduction shall be 100% of such dividends. From 85-86 assessment year uniform rate of 60% for all inter-corporate dividends.	
Sec. 80N	Indian companies	Income by way of dividends received in respect of shares allotted by foreigl companies in consideration of provision of any patent, invention, model, design etc.	The quantum of deduction shall be the amount of such dividends received in convertible foreign exchange in India and being included in the assessee's Gross Total income.	The agreement of transfer of design, model etc., should have been approved by the CBDT in certain cases.
Sec. 80O	Indian companies	Income by way of royalty, commission, fees etc., received from a Foreign Govt. or foreign company in respect of shares allotted by the latter in consideration of supply of patent, invention, model etc,	From 85-86 asst. year 50% of such dividends. The quantum of deduction shall be restricted to such dividends included in Gross Total income of the assessee and being received in India or brought into India in convertible foreign exchange.	—do—

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Sec. 80P	Cooperative Societies	Income from certain specified activities included in the assessee's gross total income.	From 85-86 asst. year 50% of such income. The quantum of deduction shall be actual sums from certain specified activities included in the assessee's Gross Total Income.	—
Sec. 80QQ	All assessees	Profits and gains from business of publication of books included in the assessee's gross total income.	The quantum of deduction shall be 20% of such profits and gains referred to in column (3). In cases where deduction is allowed under Section 80HH or 80HHA. Section 80I, Sec. 80J, Sec. 80P in relation to such profits and gains, then the deduction shall be 20% of such profits and gains as reduced by deductions allowed thereunder.	This concession is available upto the assessment year 1986-87.
Sec. 80QQA	Individual resident in India	Income by way of consideration or royalty or copyright received in exchange of publication of a book written by the assessee in any of the Indian Languages notified in the Eighth Schedule to the Constitution.	The quantum of deduction shall be 25% of income referred to in column 3 and being included in the assessee's Gross Total Income.	The book written by the assessee must be in the nature of a dictionary, thesaurus, encyclopaedia or a prescribed text book by a University.

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Sec. 80R	Individuals being citizens of India.	Remuneration received by the assessee from a university or other educational institution or any other notified institution for his services as professor, teacher etc.	The quantum of deduction shall be 50% of income referred to in column (3) which is included in the assessee's Gross Total Income.	The deduction shall be allowable in respect of remuneration for a period of 36 months only if the individual continuously served out of India in such institution for a period of more than 36 months.
Sec. 80RR	Individuals being resident in India and who are authors, playwrights, artists, musicians etc.	Income derived from foreign government or non-residents in India in the exercise of assessee's profession.	25% of income referred to in column (3) and included in the assessee's Gross Total Income.	The assessee should have received or brought, such income into India in convertible foreign exchange.
Sec. 80RRA	Indian citizen.	Income received by a individual in foreign currency from a foreign employer or an Indian concern for any services rendered outside India.	50% of income referred to in column (3) and included in the assessee's Gross Total Income.	Terms and conditions of service must have been approved by th Central Government. The concession can be claimed for 36 months only when service is for continuous period of more than 36 months.
Sec. 80S	All non-corporate assessees.	Income by way of compensation for the loss of agency etc. concerned in Sec. 28 (ii) and being included in the assessee's gross total income	25 per cent of income referred to in column (3). The maximum deduction allowable is Rs. 1,00,00.	—

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Sec. 80T	- do -	- do -	Long-term capital gains included in the assessee's gross total income.	Where such long-term capital gains do not exceed Rs. 5,000. then the whole amount of such capital gains. In case where they exceed Rs. 5,000, then at the rates specified in Twelfth Schedule.	Deduction in respect of long-term capital gains from jewellery etc. shall not exceed Rs. 50,000.
Sec. 80TT	- do -	- do -	Winnings from Lotteries included in the assessee's gross total income.	Where the income referred to in column (3) does not exceed Rs. 5,000, then entire such income. In other cases Rs. 5,000+50 % of such income in excess of Rs. 5,000.	—
Sec. 80U	Individuals resident in India and who are either totally blind or otherwise physically handicapped and such a physical disability should be one specified in the rules made by the Board.		Assessee's income.	Rs. 10,000	The assessee should submit a certificate from an oculist or a Registered Medical Practitioner as the case may be.

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Sec. **80V**	All assessees.	Interest paid on moneys borrowed for the payment of tax due under the Income tax Act.	Entire interest paid referred to in column 3.	—
Sec. **80VV**	All assessees.	Expenditure incurred in the previous year in respect of any Income-tax proceedings relating to determination of any liability under the Act by way of tax, penalty and interest.	Expenditure referred to in column 3 subject to a maximum of Rs. 5,000.	—

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL

F.S.P. (I) Tax – 1

FINAL COURSE

INCOME-TAX

STUDY – I

TAXATION OF INCOME AND THE BASIS OF CHARGE

(Sections 1 to 13, 60 to 69 D and 90 to 94)

Contents :

1. SCOPE AND APPLICATION OF THE ACT (SECTION-1)
2. DEFINITIONS OF IMPORTANT TERMS USED IN THE ACT (SECTION 2).
3. PREVIOUS YEAR (SECTION 3),
4. BASIS OF CHARGE (SECTION 4).
5. TOTAL INCOME AND ITS SCOPE (SECTIONS 5 AND 7).
6. RESIDENCE IN INDIA (SECTION 6).
7. PREVIOUS YEAR FOR DIVIDEND INCOME (SECTION 8).
8. INCOME DEEMED TO ACCRUE OR ARISE IN INDIA (SECTION 9).
9. INCOME COMPLETELY EXCLUDED FROM THE COMPUTATION OF TOTAL INCOME (SECTION 10).
10. TAX HOLIDAY FOR INDUSTRIAL UNITS IN FREE TRADE ZONES (SECTION 10A).
11. TAX EXEMPTIONS TO CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS (SECTIONS 11, 12, 12A AND 13).
12. TAX EXEMPTION TO POLITICAL PARTIES (SECTION 13).
13. INCOME OF OTHER PERSONS INCLUDED IN THE ASSESSEE'S TOTAL INCOME (SECTIONS 60 TO 65).
14. AGGREGATION OF INCOME (SECTIONS 68, 69, 69A TO 69D).
15. DOUBLE TAXATION RELIEF (SECTIONS 90 AND 91).
16. SPECIAL PROVISIONS RELATING TO AVOIDANCE OF TAX (SECTIONS 92 TO 94).

Prescribed Reading : 1. Indian Income-tax Law and Practice *by Sukumar Bhattacharya (Latest Edition)*

2. Income-tax Act, 1961 as amended upto date

Book for Additional Study : *The Law and Practice of Income-tax* by Kanga and Palkhivala (Latest Edition)

1. SCOPE AND APPLICATION OF THE ACT (Section 1) : The Income tax Act, 1961 provides for the levy of tax on certain incomes at the rates specified by the Finance Act passed annually. Should any delay occur in the passing of the Finance Act, operative for any assessment year, Section 294 provides that the Income-tax Act shall be operative, as if the rates in force in the preceeding assessment year, as laid down by the Finance Act operative in the preceeding assessment year, or the rates proposed in the Finance Bill then before the Parliament whichever are more favourable to the assessee, were actually in force. The Act extends to the whole of India.

2. DEFINITIONS (Section 2) : Students should refer to Section 2 of the Act for a study of the definitions of the various terms and phrases used in the Act. Some of the important definitions have been discussed below while others have been discussed at their appropriate places. It may be noted that in fact some of these definitions have already been discussed briefly in the Intermediate Study papers. However for the sake of revision they have been covered once again in this study.

2. Income [Section 2 (24)] : Under this clause the meaning of the word, 'Income' includes the following :

(i) profits and gains ;

(ii) dividend ;

(iii) voluntary contributions in cash or kind received by a trust or institution created wholly or partly for charitable or religious purposes : [However, contributions received with a specific direction to the effect that they shall form part of the corpus of the trust or institution would not be treated as income.]

(iv) the value of any perquisite or profit in lieu of salary taxable under Section 17 ;

(v) the value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause (iii) or clause (iv) of sub-Section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee ;

(vi) any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.

(vii) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person having a substantial interest in the company or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid ;

(viii) (i) any compensation or other payment chargeable to tax under Section 28, (ii) or any amount chargeable to tax in the hands of a trade, professional or similar association under Section 28 (iii) and deemed profits assessable under Sections 41 and 59 ;

(ix) the value of any benefit or perquisite taxable as business income under Section 28 (iv) ;

(x) any capital gains chargeable to tax under Section 45;

(xi) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of the provisions contained in the First Schedule to the Act;

(xii) any annuity due, or the commuted value of any annuity paid under Section 280D; and

(xiii) any winnings from lotteries, cross word puzzles, races incl.ding horse races, card games or any other games of any sort or from gambling or betting of any form or nature whatsover.

The definition given in the Act is not exhaustive; it also covers such other items or things as the word signifies according to its natural import. 'Income' is a more general term than 'profits' or 'gains' and the term 'income' is not limited by the words "profits and gains". A receipt may be taxable as income although it may not contain any element of profit and gain The taxability of income is not also affected by the fact that it was derived from the exercise of statutory powers.

Income need not necessarily arise from any business activity, investment or outlay or any enforceable obligation to pay; it may be voluntary or may be attributable to some custom, traditional obligation or usage. But mere casual receipts or windfalls *e g* , money found on road side, do not generally constitute income. Voluntary payments, in order to be taxable as income in the hands of the recipient, must have a source or origin which a practical man would regard as a real source of income. But one cannot earn income from himself. The character of receipt in the hands of the recipient is an essential factor for determining the taxability or otherwise of the receipt as income under the Act. This aspect has been discussed later in this Study Paper under the topic 'Charge of income-tax'.

The word 'income' as used in the Act connotes a periodical monetary return coming in with some sort of regularity or expected regularity from difinite sources. The source need not necessarily be one which is expected to be continuously productive: but it must be one whose object is the production of a definite return. Thus, income is likened to the fruit of a tree or the crop of a field though such picturesque similies cannot be used to limit the true character of income. Anything which can be reasonably and properly described as income is taxable under the Act unless expressly exempted, but anything in the nature of a windfall will be excluded.

Further, income need not necessarily be a recurrent return from a difinite source; in fact it may not recur at all and the source may never yield a periodic return. An isolated transaction or adventure may constitute business. Even a casual and non-recurring receipt may be income though it may be exempt from tax in certain circumstances under Section 10(3). The taint of illegality of wrong doing which may have been associated with income, profits or gains is immaterial for purposes of taxation, as long as the receipt can be brought within the meaning of word income, it is

taxable. Income is taxable notwithstanding the pendancy of another's claim to it. The receipt is taxable although there may be a rival claim to the income or its source or both and recipient may, as some point of time, have to give up the income and account for what he is taxed upon. But a mere claim by a person against another who has actually received the money is not sufficient to make the income occur to the claimant and render him liable to tax. A mere relief from expense is not income, *e.g.*, the relief granted to the auctioneer could not be regarded as his income. Where deposits received by a businessman in substance partake more of the nature of trading receipts than of security, such deposits if unreturned, would be taxable as income. But unclaimed dividends do not become income merely because the amount is credited to the Profit and Loss Account when they become time-barred. Similarly, interest earned by solicitor on moneys deposited with him by his clients would not constitute his income because he stands in a fiduciary position to his clients. In cases where the income is received in kind (*e.g.*, debentures issued in the place of dividends or interest) the amount of the income has to be taken as the equivalent of cash (*i.e.*, the market value) as on the date of receipt of the same.

2.2 **Agricultural Income** [Section 2 (1)] : Agricultural income is exempt from income-tax because under the Constitution, the Parliament has no power to levy tax on agricultural income. State legislatures alone are competent to impose a tax on agricultural income which is exempt from income tax under the Act. Under Section 10 (1) agricultural income is excluded from the gross total income of an assessee. Based upon the recommendations of the Raj Committee on Taxation of Agricultural Income and Wealth, the Finance Act, 1973 has, however, introduced new provisions for the aggregation of agricultural income with non-agricultural income in the case of non-corporate taxpayers with effect from the assessment year 1974-75. The details of the rules for aggregation are discussed in Study Paper IV. However, income from non-agricultural lands, even though the lands may be subject to land revenue, is not exempt from income-tax.

In order to constitute agricultural income all the following conditions should be satisfied : (i) The receipt should have been in the nature of a rent or revenue. (ii) The rent or revenue should have been derived from land. (iii) The land should have been used for agricultural proposes.

Agricultural income may also be a receipt resulting :—

(a) any income being derived from such land by : –

(i) agriculture ; or

(ii) the performance of any process ordinarily employed by a cultivator or the receiver of rent-in-kind to render the produce raised or received by him fit to be taken to the market ; or

(iii) the sale of the produce raised or received by a cultivator or receiver of rent-in-kind in respect of which no process [other than the one specified in (ii) above has been performed.

(b) any income derived from any building owned and occupied by the receiver

of the rent or revenue in cash or kind of any such land or occupied by the cultivator or the receiver of rent-in-kind of any land with respect to which or the produce of which, any process mentioned in (a) (ii) stated above is carried on.

However, income derived from a farm house referred to in (b) above, would be treated as agricultural income *only if* the following conditions are satisfied.

(a) the building is on or in the immediate vicinity of land and it is a building which the receiver of the rent or revenue in kind, by reason of his connection with the land, requires as his dwelling house or store-house or other out-building ; and

(b) the land is assessed to land revenue in India or is subjected to local rate assessed and collected by the officers of the Government as such ;

or the land is situated beyond (i) the limits of any municipality; municipal corporation, notified area, town area, cantonment board [or known by any other name] provided that the population of the municipality, *etc.* exceeds 10,000 as on the first day of the accounting year according to the last preceding census for which the relevant figures have been published : or (ii) such distance (not being more than eight kilometres) from the local limits of any municipality or cantonment board, *etc.*, referred to above as the Central Government may, having regard to the extent of and the scope for urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette.

Agriculture income is exempt, however, and by whomsoever it is received, even if it is received as a part of the business profits. Non-agricultural income does not become agricultural merely on account of its indirect connections with the land. In cases where the assessee's income is partly agricultural and partly from manufacturing operations (*e.g.*; cases where the assessee grows tea, cotton, sugarcane or tobacco) and subjects it to a manufacturing process and sells the manufactured product—the profit on the sales will have to be apportioned to ascertain the agricultural profit and the profit attributable to the business of manufacturing and selling operations. The former would then be exempt from tax. Rules 7 and 8 of the Income-tax Rules, 1962 provide the basis of such apportionment in the case of sugar, tea and similar industries. But a dividend paid by a company out of its agricultural income is not exempt from tax as agricultural income in the hands of the shareholder since there is no direct ownership by shareholder of the agricultural land.

2.3. **Dividend** [Section 2 (22] : The term *'dividend'* has been defined to *include* :

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution *entails the release* by the company to its shareholders of all or any part of the assets of company ;

(b) any distribution to its shareholders by a company of debentures, debenture-stock or deposit certificates in any form, whether with or without interest and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits whether capitalised or not ;

(c) *any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not ;*

(d) any distribution to its shareholders by a company on the reduction of its share capital in respect of profits which arose after the end of the previous year ending next before the first day of April, 1933, whether such accumulated profits have been capitalised or not;

(e) any payment by a company, being a company in which the public are not substantially interested, of any sum (whether as representing to a part of the assets of the company or otherwise) by way of advance or loan a registered shareholder being a person who has a substantial interest in the company or any payment by any such company on behalf, or for the individual benefit of any such shareholder to the extent to which the company, in either case, possesses accumulated profits.

But "dividend" does *not* include :

(i) a distribution made in accordance with item (c) or (d) above in respect of any share is issued for full 'cash' consideration where the holder of the shares is not entitled, in the event of liquidation, to participate in the surplus assets;

(ii) a distribution made in accordance with item (c) or (d) above in so far as such distribution is attributable to the capitalised profits of the company representing bonus share allotted to its equity shareholders after the 31st day of March, 1964 and before the 1st day of April, 1965;

(iii) any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is the substantial part of the business of the company;

(iv) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of item (e) above the extent to which it is so set off.

The definition of notional dividends would not apply to a distribution or other payment made by a foreign company unless the foreign company falls within the definition of a 'company'. But a dividend proper under the general law received from a foreign corporation which is not a company within the meaning of Section 2 (17) would, nevertheless, be liable to tax apart from this definition.

The term 'dividend', as used in the Income-tax Act, has a much wider scope and meaning than those in the ordinary commercial sense; the definition is inclusive and not exhaustive and covers various items of distribution by a company which may not normally be regarded as dividend. Dividend need not necessarily be paid in cash; it may be paid in money's worth by the delivery of, say goods, securities or shares of even another company. In any such case the amount of dividends must be taken as the market value of the money's worth as on the date of declaration of the dividend. Also, the non observance by the company of the formalities required under the Companies Act for declaration of dividends would not, in any way, affect the liability of the shareholder to pay tax on the dividends, It is also immaterial that it was paid out of capital or share premium in violation of the law. The

company, moreover, must deduct tax at source from the dividends at the time of payment.

Where a company capitalises its accumulated profits by the issue of bonus shares to its shareholders, the allotment of bonus shares does not entail a *release* of the company's assets. For this reason bonus shares do *not* constitute dividend or income at all when they are issued to *equity shareholders* But if they are issued to preference shareholders they would be assessable as dividend under Section 2 (22) (b). However, when the bonus shares are paid off, the payment constitutes a dividend within the meaning of Section 2 (22)(a) or (b). Distribution of bonus debentures, debenture stock or deposit certificates in any form by a company amongst its shareholders would be distiribution of dividend and consequently would become taxable as in the hands of its shareholders *but only* to the extent to which the company possesses accumulated profits, whether capitalised or not. Any distribution made to the shareholder on the liquidation of a company to the extent to which the company had accumulated profits, (other than capitalisd profits representing bonus shares) would be dividends taxable in the shareholder's hand. For this purpose a distribution on liquidation out of the accumulated profits of any past years and even out of the current year's profit of the year *upto* the date of liquidation would constitute dividend. But any distribution out of the company's profits *subsequent* to the date of liquidation would not become dividend. Similarly, a payment made by a company out of its accumulated profits for the purpose of paying off its excess share capital would also be dividends under the Section.

Further, where a company makes (i) payment of any sum by way of advance of loan to a registered shareholder, or (ii) any payment on behalf of a shareholder or (iii) any payment for the individual benefit of a shareholder, it would be taken to be dividend assessable to tax in the hands of the shareholder ***provided that*** :

(a) the company is one in which the public are not substantially interested [See Study V or Section 2 (18)] ;

(b) the shareholder is a person who has a substantial interest in the company ; (see page 9) and is the registered holder (not necessarily the beneficial holder) of the shares ; and

(c) the company possesses accumulated profits at the time of making the payment and the payments are deemed to have been made to the extent of such profits.

The above conditions do *not*, however, apply where the loan is advanced by the company in the ordinary course of its business of banking and the business of money-lending constitutes a substantial part of the business of the company. Similarly a distribut on on the liquidation of a company or on the reduction of its share capital would not constitute dividends if it is made in respect of any share (1) which has been issued for full consideration *and* (ii) the holder is not entitled to participate in the event of liquidation

The Supreme Court held in *C I.T. v. Rameshwarlal Samwarmal [1980] 22 ITR 1* and in *C.I.T. v. C P. Sarathy Mudaliar [1972] 83 ITR 170* that in order to fall under Section 2 (22) (e) the loans should be advanced to the registered shareholder and not to the beneficial owner like say, HUF.

For purposes of this clause the expression '*accumulated profits*' means all profits including general reserves and development rebate or other reserves of the company accumulated upto the date of distribution but does not include non-taxable capital gains. Any distribution made to the shareholder of a company on liquidation out of its non-taxable accumulated capital gains (*e. g.*, capital gains made on sale of agricultural land situated outside the municipal limits or other urban areas or the notified adjoining areas) would not amount to dividend. Thus, if a company pays any sum whether called dividend or bonus out of its profits realised on the sale or disposal of its capital assets the payment would, nonetheless, constitute dividend in the hands of the shareholder chargeable to income tax.

2 4 **Company** [Section 2 (17)] : Under the Income tax Act the term 'company' has a much wider connotation than under the Companies Act. For puposes of income tax a 'company' means :

(i) any Indian company, or

(ii) any body corporate incorporated by or under the laws of a country outside India or ;

(iii) any institution, association, or body which is or was assessable or was assessed as a company under the 1922 Act or under the 1961 Act for any assessment year prior to 1970-1971.

(iv) any institution, association, or body whether incorporated or not and whether Indian or non-Indian and whether carrying on business in India or not, which is declared by any general or special order of the Central Board of Direct Taxes to be a company for the purposes of this Act.

An 'Indian company' [referred to in (i) above] as defined in Section 2 (26) means a company formed and registered under the Companies Act, 1956 and includes—

(a) a company formed and registered under any law relating to companies formerly in force in any part of India [other than the State of Jammu & Kashmir and the Union Territories specified in (c) below] ;

(b) in the case of the State of Jummu & Kashmir company formed and registered under any law for the time being in force in that State ;

(c) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;

(d) a corporation established by or under a Central, State or provincial Act : and

(e) any institution, association or body which is declared by the Board to be a company under Section 2 (17) It is however, essential that in all cases the registered or, as the case may be, principal office of the company, corporation, institution, or body *must* be in *India*.

Thus, under the Act even an unregistered or an unincorporated association may be declared to be a company and consequently what is not a legal entity may be asses-

sable as a company. Even a company registered under Section 25 of the Companies Act without a commercial or profit making motive would be assessed as a company for income-tax purposes. For all purposes of assessment including the levy of penalty, a company in liquidation would be a company within the meaning of this clause and the liquidator would have all the obligations of a principal officer of the company. However, an assessment on a company cannot be made after it has ceased to exist and its name has been struck off from the Register by the Registrar of Companies as a defunct company.

2.5 **Person Having a Substantial Interest in the company** [Section 2 (32)] : This phrase, in relation to a company, means a person who is the beneficial owner (not necessarily the legal owner) of shares, not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, carrying not less than 20% of the total voting power. Thus the registered holder of even the majority of equity shares would not fall within the definition if he has no beneficial interest in the shares

Capital Assets [Section 2 (14)] : The expression 'capital asset' means property of any kind held by an assessee whether or not connected with this definition or profession, but *does not* include : -

(i) Stock-in trade, consumable stores or raw materials held for the purpose of the business or profession of assessee ;

(ii) personal effects of movable property including wearing apparel and furniture, but excluding jewellery, held for personal use by the assessee or any of his dependent family members.

(iii) rural agricultural lands in India ; and

(iv) 6½% Gold Bonds 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980 issued by the Central Government.

(v) Special Bearer Bonds, 1991 issued by the Central Government.

Capital assets include goodwill, leasehold rights, a partner's right or share in the firm, manufacturing licence and the right to subscribe for the share of a company.

The definition of 'capital asset' contained in Section 2(14) includes agricultural lands situated within the limits of any municipality whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name or a cantonment board having a population of 10,000 or more according to the last census for which the figures have been published before the first day of the previous year. Further, agricultural lands situated in areas lying within a distance of not more than 8 kilometers from the local limits of such municipalities or cantonment boards would also be covered by the amended definition of 'capital asset' provided that such areas are, having regard to the extent and scope of their urbanisation and other relevant considerations, notified by the Central Government in this behalf. Consequently any capital gains arising from the transfer of agricultural lands situated in municipal or other urban areas or notified adjoining areas will be liable to income-tax. However, under Section 47 (viii) capital gains arising from the transfer of such lands effected prior to 1-3-1970 have been excluded from taxation. Agricul-

tural lands situated in rural areas will continue to be outside the scope of this definition and the gains, if any, arising on their transfer would, consequently, be exempt from tax under this Act.

It may be noted that jewellery is treated as a capital asset and the profits and gains arising from the transfer of jewellery held for personal use will be chargeable to tax under the head 'capital gains'. In other words, profits from the sale or other transfer of personal jewellery would no longer be exempt from tax. For this purpose, the expression '*jewellery*' has been defined to include—

(i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel ; and

(ii) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

2.7 **Short-term Capital Asset** [Section 2 (42A)] : This expression means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer.

In order to calculate the period for which the shares in a company in liquidation were held by the assessee the period after the date of its liquidation must be excluded. In cases where the capital asset became the property of the assessee under Section 49 (i) *i.e.*, on partition of a H U.F., inheritance, dissolution of a firm or association of persons the period for which the asset was held by the previous owner shall also be added to the period for which the asset was held by the assessee in order to determine whether the asset had been held for more than 36 months by the assessee or not.

Capital gains arising on the transfer of any short term capital asset are assessable to tax at the rates applicable to ordinary income whereas gains arising from the transfer of other (long-term capital assets) (*i.e.*, capital assets other than short-term capital assets) are taxable only in part as they are entitled to deduction under Section 80T or concessional treatment under Section 115.

2.8 **Transfer** [Section 2 (47)] : The term 'transfer' in relation to a capital asset includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law. The meaning of term 'transfer', as given above, has bearing only in relation to a capital asset but not in relation to any other context in which the word has been used in the Act.

2.9 **Assessee** [Section 2 (7)] : The term "assessee" means a *person* [as defined in clause (31)] by whom income-tax or any other sum of money including penalty or interest is payable under the Income-tax Act. It also includes every person in respect of whom any proceeding under this Act has been taken for the assessment (a) of his income or loss or (b) of the account of refund due to him.

Thus, the definition covers two categories of persons (i) persons by whom any tax, interest or penalty is payable under the Act whether or not any proceeding under this Act has actually been taken against them : and (ii) persons against whom any

proceedings under the Act have been taken whether or not they are liable to pay any tax, interest or penalty.

Further, the definition covers also a person who is assessable in respect of the income or loss of another by virtue of the provisions of Sections 60 to 65, 92, 159, 160 or 163, or who is deemed to be an assessee under Section 160 or an assessee in default under Section 201. However, under an agreement between two persons, if one promises to pay the tax dues of another, the Revenue not being a party to the agreement, cannot treat the promisor as the assessee and demand from him the tax due by the promisee.

2.10 Person [Section 2 (31)] : For all purposes of the Act the term 'person' includes (i) an individual, (ii) a Hindu undivided family: (iii) a company; (iv) a firm; (v) an association of persons or a body of individuals whether incorporated or not; (vi) a local authority; and (vii) every artificial juridical person, e g a deity, idol or statutory corporation.

This term also includes a minor or a lunatic, the Government of any State in India when engaged in any commercial enterprise. However, the estate of a deceased person is not a person or assessable entity; the assessment in such a case should be made on the legal representative.

2.11 Amalgamation [Section 2 (1A)] : The term 'amalgamation' in relation to companies means the merger of one or more companies with any other company or the merger of two or more companies to form one company. The company which so merges is called the amalgamating company and the company with which it has merged or which is formed as a result of the merger is called the amalgamated company. An amalgamation to be valid and effective should satisfy all the following conditions :

(i) All the property of the amalgamating company or companies immediately before the amalgamation should become the property of the amalgamated company.

(ii) All the liabilities of the amalgamating company or companies immediately before the amalgamation should become the liabilities of the amalgamated company by virtue of the amalgamation.

(iii) The shareholders holding not less than 9/10th in the value of the shares in the amalgamating company or companies other than the shares already held therein immediately before the amalgamation by, or by a nominee, for the amalgamated company or its subsidiary must become shareholder of the amalgamated company by virtue of the amalgamation. However, cases where the property of one company is acquired by another company (i) as a result of the purchase of such property by the former or (ii) as a result of the distribution of such property to the former company on the winding up of the latter company, would not constitute amalgamation.

2.12 Interest : under Section 2 (28A) the term 'interest' must be taken to *mean* the interest payable in any manner in respect of and moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and must also be taken to include any service fees or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised. Since the

definition appears along with the other definitions contained in Section 2 of the Income tax Act the meaning of the word "interest" as contained in the new definition must be applied in every case wherever the term "interest" is used in the Income-tax Act.

3 PREVIOUS YEAR (Section 3)

3.1 Meaning : Income-tax, as already stated for any financial year is to be charged in respect of the total income of the 'previous year' of a person. In point of time, this previous year indeed covers a period preceding the financial year i.e. the assessment year for which the tax is to be charged; but it need not necessarily be the preceding financial year. The scheme is to levy tax for each 'tax year', (i.e., the financial year) on the income of a period covered by one full year ending within the financial year immediately preceding the ' tax year". The assessee has the right to choose this period under certain conditions and this period is termed statutorily as the 'previous year'. It has been defined in Section 3 of the Act. The income tax from any person for any year is not to be charged on any income that is earned in a period falling closely prior to the tax year.

The expression 'previous year' substantially means an accounting year comprising a full period of twelve months and usually corresponding to a financial year preceding the financial year of assessment. It also means an accounting year comprising a full period of twelve months adopted by the assessee for maintaining his accounts but different from the financial year and preceding a financial year. Previous year may also be, a calendar year, Diwali year. Samvat year, Saka year, Tamil or Telugu year depending upon the accounting year followed by the assessee. In such cases, an option is given to the assessee to have as the previous year either the immediately preceding financial year or the period ending with such year for which he had made up his accounts. This option must be exercised clearly by making a statement or by other conduct which expresses or implies the exercise of the option. Mere production of the books of account for a period other than financial year would not, however, tantamount to the exercise of the option by the assessee.

But once the previous year has been determined for a source of income, business or profession and the assessment made, with reference to any assessment year, it cannot be varied in respect of that source of income, for any assessment year following, except with the prior consent of the Income Tax Officer, and upon such condition as he may prescribe. In such a case, the Income Tax Officer may make it a condition that the previous year after the change will comprise a period which is more than twelve months and such a condition imposed is well within his powers. The recent decision of the *A. P High Court in Addl, C.I.T v. K Ramachandra Rao* [1980] 4 Taxman 281, clearly shows that the option available to an assessee under Section 3 (a) (b) regarding choice of a previovs year could be exercised in relation to salary income also

As the Delhi High Court has held in the case of *Dalmia Cement (Bharat) Ltd. v. I T.O. (1973) 88 I.T.R. 21*, the Income-tax Act. 1961 does not require the recording of reasons by the Income Tax Officer when exercising his discretion under

Section 3(4) in refusing to accord his approval for a proposed change in the "previous year" of the assessee ; nor does the Act require that the reasons for refusal must be communicated to the assessee.

The Act having conferred the discretion on the Income Tax Officer, the discretion as to whether the change in the previous year should be permitted and whether it would prejudice the interest of the revenue has to be decided by the Income Tax Officer. The court cannot examine the sufficiency or adequacy of the material on the basis of which the decision of the Income Tax Officer has been arrived at as is not justifiable. Though it is for the Income Tax Officer to exercise his discretion under Section 3(4) the discretion, if exercised arbitrarily or capriciously, is not beyond the scrutiny of the Court. Of course, the court will not substitute its own opinion or discretion for that of the Income Tax Officer. If the assessee is able to show that discretion has been exercised in *a mala fide* or arbitrary manner or on extraneous considerations the same will be subject to challenge under Article 226 of the Constitution.

In common parlance, the term "previous year" is also sometimes known as 'the 'accounting year' or the 'income year.' In law, it is either financial year immediately preceding the financial year (*i. e.*, the assessment year) for which the assessment is to be made, or a period of 12 months up to which the assessee has made up his accounts ending within the financial year immediately preceding the assessment year, The assessment year is thus always ahead of the previous year.

3.2 **Power to Determine the Previous Year** : As a general rule, the 'previous year' for any separate source of income must end on any date prior to the commencement of the assessment year. But power has been given to the Central Board of Direct Taxes or to any authority authorised by the Board in this behalf, to determine any period as the previous year in the case of any person, business or class of persons or business. In exercise of this power, the Central Board of Direct Taxes may sometimes determine as the previous year, a period exceeding 12 months or a period which does not end within the previous financial year but extends into the assessment year. For instance, an accounting year ending on April 15, 1981 may have the assessment year 1981-82 if the income tax authorities so decide.

3.3 **Newly set up Business or Profession** : If no accounts have been maintained for the newly set up business or profession, the 'previous year' for the income arising therefrom shall be the period commencing from the date on which such business or profession was set up and ending on 31st of March next following. The income of this period will be charged to tax in the assessment year (financial year) next following. If, however, the assessee has made up the account to any date, and if these accounts do not cover a period exceeding 12 months from the date of setting up of the business or profession, the 'previous year' shall be the period commencing from the date of setting up of the business or profession and ending with the date upto which the accounts have been made up. Accordingly, the income earned during this period, shall be charged to tax in the financial year next following the financial year within which the accounts were made up.

For instance, if a business was set up on 1st July, 1981 and the accounts made up to, 30th June 1982 the previous year of this new source of income would be the year ended on 30th June 1982 and in that case there shall be no 'previous year' for the assessment year 1982-1983 Accordingly, the income of the year ending on 30th June, 1982 shall be charged to tax in the assessment year 1983-84. But if this very assessee, who sets up the business on 1st July, 1981 did not maintain any accounts for this source of income, the 'previous year' for the assessment year 1982-83 shall be a period of nine months ending on 31st March, 1982.

Even in respect of income from a newly set-up business or profession, the *Central Board of Direct Taxes is authorised to determine the* 'previous year' which *can be the period commencing from the date the business was set up and ending on* any date prescribed by the Central Board of Direct Taxes. Where the accounts for the first time are closed after a period exceeding 12 months in the case of a new business or profession, the Central Board of Direct Taxes may also determine any period to be the previous year. Where an assessee has newly set up any business or profession in the financial year and his accounts are made up to a date in the assessment year in respect of a period not exceeding twelve months from the date of setting up of the business, *then at the option* of the assessee, he would be deemed to have no previous year for that assessment year.

Where an assessee has made up his accounts for a period exceeding twelve months, he cannot claim the benefit of the option of choosing his own accounting period as the previous year In the case of any newly set up business the accounting year must necessarily commence on the date of setting up of the business and not when it actually commenced its operations.

Where a business changes hands, the predecessor and the successor should each be assessed in respect of his actual share, if any of the profits of the previous year, the accounting period remaining unchanged.

3.4 Previous Year of a Partner : In respect of a partner's share in the income of a firm in which he is a partner, the previous year must necessarily be the same as that of the firm, if it has been assessed *but* the previous year for his personal income may be different. If the firm has not been assessed as such or if the assessment is made directly on the partners in respect of their share of the firm's income without any assessment being made on the firm at all the previous year of the partner would be the period of 12 months for which accounts have been made provided that the period of 12 months ends before the commencement of the assessment year or one as determined by the Board or on its behalf

3.5 Separate Previous Year for each Source of Income : An assessee is entitled to have as many previous years as he has sources of income and different previous years of different sources for income even if all of them are assessable under the same head of income and in the same assessment year Each branch of a business, for this purpose would constitute a separate source of income In cases where an assessee has different previous years in respect of separate sources of 'income', the income of the varying previous years from the different sources should be lumped together to

arrive at the total income. Except in cases where the previous year is determined by the Board or any authority authorised on its behalf, all the varying previous years must necessarily end with or within the financial year immediately preceding the assessment year. The fact that even a company can have more previous years than one is recognised by Section 2 (8) of the Companies (profits) Surtax Act, 1964 as well. There are, however, four exceptions to the general rule that the income of the previous year alone would be assessed in the assessment year. The *exceptions* relate to the assessments in the cases of : --

1. Shipping business of non-residents (Section 172).
2. Persons leaving India (Section 171).
3. Persons trying to alienate their assets with a view to avoiding tax (Section 175)
4. Discontinued business or profession (Section 176).

These exceptions are discussed in Study Paper VI.

4. CHARGE OF INCOME-TAX (Section 4)

4.1 **Basis of Charge** : This Section is the backbone of the Income-tax Act in so far as it serves as the most operative Section of the Act and in its absence the other provisions of the Act cannot be enforced. This Section imposes income tax upon a person on his total income ; but tax does not constitute a charge on the income upon which it is levied. The liability to tax of any assessee does not depend on the assessment or on the passing of the Finance Act but arises or springs from this charging Section alone and it arises not later than the close of the previous year even though the quantification of the amount of tax payable is postponed to the date of the assessment. The charging Section provides that :—

(i) income-tax shall be charged at the rate or rates fixed for the year by the annual Finance Act ;

(ii) the charge is on every person including the assessable entities specified in Section 2 (31) ;

(iii) the income taxed is that of the previous year and not of the year of assessment ; and

(iv) the levy of tax shall be made on the total income of the assessable entity computed in accordance with and the subject to the various provisions contained in the Act.

For purposes of making the assessment, the law to be applied is that in force in the relevant assessment year and not the one relating to the previous year or the accounting year.

4.2 **Capital and Revenue** : Since income-tax is to be charged on income and not on capital it is essential to distinguish between capital and income particularly in view of the fact that the Act has not precisely defined the term 'income'. Where a single amount received by the assessee is partly on capital account and partly on revenue account, it should be apportioned between the two and the revenue part alone is to

be brought to charge. However, while determining whether a cartain receipt is of a capital or a revenue nature the following points are *immaterial* for consideration :

(i) *Measurement :* Where a certain payment is to be measured on the basis of the estimated annual yield or profits (*e.g.*, computation of damages) the payment does not necessarily become a revenue receipt.

(ii) *Quantum and periodicity* : The fact that an amount is paid in lump sum or in instalment at regular intervals of time, does not also form the basis for determining whether the receipt is capital or revenue. Thus, the frequency and the quantum or magnitude of the receipt do not constitute the factors determining the nature of the payment.

(iii) *Name* : The name given to a transaction by the parties concerned or the treatment given to the transaction in the accounts of the parties would not decide the nature of the receipt for tax purposes. Thus it is only the real character of the payment and not necessarily what the parties call it which is the deciding factor for ascertaining whether a certain sum is taxable or not.

(iv) *Form* : The form of the transaction equally immaterial if on its true construction the transaction escapes tax as being on capital accounts since the same result could be brought about by or through a transaction in another form which would also yield taxable income However, an assessee has the legal right to dispose of his capital and income in such a way as to attract upon himself the least amount of tax.

(v) *Nature of the asset* : Profit arising from the use of capital invested in wasting assets like mines, quarries, annuities, timber-bearing forests or nitrate grounds which are consumed and exhausted in the proce s of realisation would, nonetheless, constitute taxable income. For these purposes it is immaterial to consider the facts that : (i) the assessee does not own the asset except for the right of lease ; (ii) the asset and the capital employed are assumed and exhausted in the course of earning the income ; and (iii) the income had come from a wasting asset which would cease to exist after a certain point of time.

(vi) *Receipt, Source and Application* : The nature of the receipt must be determined entirely by its character in the hands of the recipient and the source from which payment has been made is immaterial for this purpose. Thus if an amount is paid which so far as the payer is concerned, is out of capital whether wholly or in part (*e.g.*, payment of interest out of capital under Section 208 of the Companies Act) and the receiver receives it as income on his part, the entire receipt is taxable in the hands of the receiver irrespective of the fact that the payment is out of capital. The purpose of application of a certain receipt has nothing to do with its taxability

(vii) *Disallowance in the Assessment of Payer* : Also, the fact that a certain payment was disallowed as a revenue deduction in the hands of the payer, would not make it a capital receipt in the hands of the recipient and thus

would be taxable in his hands.

4.3 **Distinction Between Capital and Revenue Receipts :** The following are some of the important criteria which may be applied to distinguish between capital and income receipts :

1. A receipt referable to fixed capital would be a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt The former is exempt from tax while the latter is taxable. Circulating capital is the capital which is turned over and, in the process of being turned over, yields profit or loss. Fixed capital is that involved directly in the process but still remains unaffected by the process. Circulating capital or stock-in-trade is also known as trading asset and fixed capital as capital asset. A capital asset in the hands of one person may be a trading asset in the hands of another and the nature of the receipt may consequently have to be determined on the basis of the nature of the trade, in the course of or in connection with which it arises. In other words, the determining factor should be the nature of the trade in which the asset is employed. Thus reimbursement of capital outlay is capital receipt even if the total amouut of receipt may exceed the cost of outlay. Similarly, compensation received for the immobilisation, sterilisation, destruction or loss, whether total or partial, of a capital asset is a capital receipt whereas compensation for injurious affection to a trading asset would be a revenue receipt chargeable to tax. In cases where a capital asset is transmeted into income and the price realised on its sale takes the form of periodic payments of revenue nature (*e g.*, annuities) and annual instalments of capital the revenue receipt would be taxable even though it is referable to a capital asset.

2. Profits arising from the sale of capital assets are chargeable to tax as capital gains under Section 45 whereas profits arising from the sale of trading assets being of a revenve nature are taxable as income from business under Section 58 provided that sale is in the regular course of the assessee's business or the transaction constitutes an adventure in nature of trade. A mere enhancement in the value of a capital asset would not become a revenue receipt chargeable to tax as income from business. The profits arising from the purchase and sale of shares (in the hands of a non-dealer in shares), gold, silver, land, buildings, plant or machinery would constitute an accretion to capital chargeable as capital gains. Also, an isolated sale of trees with roots may be treated as a capital transaction. But where the purchase and sale of mining rights, ships, wagons, *etc.* are carried on by the assessee in the course of his trade and in pursuance of a scheme of profit making the transactions would result in trading profits since the asset would constitute a trading asset.

3. Profits arising from transactions which are entered into in the course of the business regularly carried on by the assessee or are incidental to or associated with the business of the assessee would be revenue receipts chargeable

to tax. For example, a banker's or financier's dealings in foreign exchange or sale of shares, and securities, a ship broker's purchases of ships in his own name, the sale of passenger ships by a company carrying on business as ship builders and repairers and also operating a passenger boat service, a share broker's purchase of shares on his own account would constitute transaction entered into and yielding income in the ordinary course of the assessee's business. But even in these cases the receipts may be on capital account, under certain circumstances. In respect of transactions which are outside the ordinary course of the assessee's business, the taxability of the income arising from such transactions would depend upon the fact whether or not the transaction in question is in the nature of a trade. If the transactions are partly in the course of and partly outside the regular trading activity of the assessee, the income arising therefrom must be segregated and allocated between the two parts and treated accordingly for tax purposes.

4. In the case of profits arising from the sale of shares and securities the nature of the profits has to be ascertained from the motive, intention or purpose with which they were brought. If the shares acquired as an investor or with a view to acquiring a controlling interest or for obtaining a managing or selling agency or a directorship the profit or loss on their sale would be of a capital nature ; but if the shares were acquired in the ordinary course of business as a dealer in shares it would be of revenue nature. If the shares were acquired with a speculative motive, the profit or loss though of a revenue nature, would have to be dealt with separately from other business. Similarly, in the case of profits arising from the sale of land, buildings or other capital assets the treatment for income-tax purposes would depend upon the motive and intention behind the transaction.

4. Even a single transaction may constitute a business or an adventure in the nature of trade even if it is outside the normal course of the assessee's business. It is not necessary that there must be repetition or continuity of such transactions so as to constitute an adventure in nature of trade. Thus, a bulk purchase followed by bulk sale or a series of retail sales or a bulk sale followed by a series of retail purchases would constitute an adventure in the nature of trade and, consequently, the income arising thereform would be taxable. Therefore, a receipt to be of a revenue nature need not necessarily be repetitive or recurring. But every speculative transaction, though isolated in nature ; is an adventure : it need not necessarily be in the nature of a trade. Similarly, purchase of any article or capital asset with no intention to resell it but resold under changed circumstances would be a transaction of a capital nature and consequently the profit arising therefrom would be capital gains and not business income. However, where an asset is purchased with the intention to resell it, the question whether the profit on sale is capital or revenue in nature

would depend upon : (i) the conduct of the assessee, (ii) the nature and quality of the article purchased, (iii) the nature of the operation involved, (iv) whether the venture is on capital or revenue account, and (v) other related circumstances of the case.

6. In the case of annuities which are payable in specified sums at periodic interval of time, the receipt would be of a revenue nature even though it involves the conversion of capital into income, for annuity means the purchase of an income. However, the fact that an annuity is contingent or variable in amount does not in any way, affect its character as income. Nevertheless, the tax on the annuity is, to some extent, also a tax on capital or an equivalent of capital in so far as income includes any returns which come from the wastage or use of capital e.g., leasehold, quarries mines, *etc.* Any annuity received from an employer is taxable as "income from salaries" whereas all other annuities are chargeable under the head 'income from other sources' irrespective of the fact whether or not they are payable (i) under a testamentary or non-testamentary trust, (ii) under a deed or family arrangement, (iii) under an insurance policy, (iv) under a deed of separation to a wife or under a decree of alimony, or (v) to the estate of a deceased partner by the remaining partners for the use of the firm's name and goodwill.

Annual payments, as distinguished from annuities, are in fact annual instalments of capital. The purchase price of a business or property may be agreed to be paid in instalments annually or otherwise. In such a case, the amounts of instalments received by the assessee would be of a capital nature not liable to tax. In order to ascertain whether a certain payment is an annuity or annual instalment of capital, regard must be had to the true nature and character of the transaction as evident from the contact which embodies the transaction and the other circumstances of the case. Thus, on the sale of a business in consideration of annual payment :—

[i] if the sale is for a price which is to be paid in instalments, the instalments would be capital receipts ;

[ii] if the property is sold for an annuity payable regularly, the property disappears and the annuity which takes its place would be chargeable to tax ;

(iii) if the property is sold for what looks like an annuity but actually there is no transmission of the principal sum into income and the annual payments are merely instalment of the principal sum with interest, only so much of the amount of instalments as representing being capital receipts ; and

(iv) if the property is sold for a consideration which is a share of the profits would be the sale price but still chargeable to tax as income provided that the true bargain was to secure an income and not a fixed capital sum. However, if the circumstances of the case show

that the receipts were only instalments of a capital nature though fluctuating in amount and measurable with reference to profits, they would not be taxble.

7. Compensation received for restraint of trade or profession is a capital receipt since it is received in substitution of the source of income itself But this principle does not apply in cases where there is a covenant not to manufacture certain materials and the compensation, therefore, merely forms an integral part of a composite agreement made in the ordinary course of business of procuring the supply of those materials. That is a receipt in substitution of a source of income and is a capital receipt not chargeable to tax. Where an assessee receives compensation for termination of its agency business the agency business being the only source of income the receipt would be of a capital nature even though it is taxable under Section 28 (*ii*). But where the assessee has a number of agencies and one of them is terminated and compensation received therefor would be of a revenue nature since taking agencies and exploiting the same for earning income is in the ordinary course of business and the loss of one agency would be made good by taking another. Compensation received from the employer for premature termination of the contract of service would be a capital receipt although taxable under Section 15 subject, however, to the exemption under Section 10 (10B). Similarly, compensation received from the Government (*i*) for use of requisition premises, (*ii*) in respect of stock-in-trade destroyed or damaged by enemy action, (*iii*) for property compulsorily acquired by the exercise of their powers in controlling and interfering with the business, would constitute revenue receipts. But compensation paid for acquisition of Zamindari lands, or leasehold property which constituted a capital asset in the hands of the lessee or compensation paid by the Government for cancellation of licence resulting in the cessation, temporary stoppage or injury to the business would be a capital receipt. In cases where the compensation received is partly of a capital and partly of a revenue nature the two will have to be segregated and treated accordingly for tax purposes.

8. A lump sum paid in commutation of salaries, pension, royalties or other periodic payments would be income taxable under the respective heads subject to certain exceptions. Amounts received under a policy of insurance would be a capital or revenue received, depending upon the fact whether the policy was held by the assessee as a capital asset or as a trading asset. Likewise, subsidies or grants received from the Government would be generally of a revenue nature since they would be to supplement the income from business. But where a grant is received for a specific purpose but not as a supplementary trading receipt (*e.g.*, to enable the company to undertake work to relieve unemployment or promote family planning) the receipt would be of a capital nature not chargeable to tax Premium or discount received by a debentureholder being a capital receipt would not be

chargeable to tax. But the discount on loans made at a discount and repayable at a premium would be a revenue receipt in the hands of a person whose ordinary business is that of money-lending. In other cases it would be a capital receipt. But where the loan carries no interest, the interest or the premium should be treated as a revenue receipt. Premium (salami) —a single payment made for the acquisition by the lessee of the right to possess and the enjoy the benefits granted to him under the lease of any land or building is normally a capital receipt since the right under the lease forms a capital asset However, where the payment of premium takes the character of advance rent (but not the price for parting with the land or building) the receipt would be taxable as income.

Mining royalties are revenue receipts taxable as income from other sources irrespective of the fact whether they are received in lump sum or by way of a fixed annual sum or as a tonnage royalty calculated on the basis of the amount of minerals extracted or the minimum royalty called as the dead rent. Similarly, royalties paid for use of patents in the past, present or future, whether paid in lump sum or in instalments of fixed or varying amounts, would be taxable as income whereas the payment received in lieu of the total or partial assignment of a patent under which the owner ceases to own the patent as a capital asset would constitute a capital receipt since the assignment resulting in or from the sale or surrender of a patent is transaction of capital nature. These principles would as well apply to royalties received for the use or assignment of copyright, technical know-how or secret formula. Profit on exchange of currencies or on devaluation of currencies would be a revenue or capital receipt in nature, depending upon the fact whether the foreign currencies are kept as stock-in-trade (*e.g.*, in the case of bank) or as investment *e g.*, capital asset. However, the profit element included in the sale or assignment of the patent or other similar rights or the exchange of these currencies would be chargeable to capital gains tax in case where the receipts threfrom are of a capital nature.

Premium on issue of shares or debentures, profit on issue of forfeited shares and the fee charged on fresh issue of shares are capital receipts not chargeable to tax (not even to capital gains tax since the shares or debentures are not capital assets of the company). Also, the amount received by shareholder on the winding up of the company would be a capital receipt [except where the receipt falls within the meaning of the term 'dividend' under Section 2 (22) irrespective of the fact whether the company originally possessed these by way of capital or profits. But in the case of a partnership, the amount receivable by an outgoing partner in respect of his share of his firm's profit whether before or after the dissolution--would be revenue receipt chargeable to tax. But compensation received by a partner for relinquishing all of his interest in the firm and amount received in settlement of a claim to an interest in the capital of a firm, are capital receipts.

Apart from the foregoing discussion, it is necessary to note that the capital or revenue nature of a receipt would have to be determined on the basis of the particular facts and circumstances of each case and the question whether a certain item is capital or revenue would be a mixed question of law and fact.

5 TOTAL INCOME AND ITS SCOPE (Sections 5 and 7)

5.1 **Meaning :** This expression is of great significance in the Act since income-tax is a charge on the total income of the assessee. Section 5 provides the meaning of total income in terms of the assessee's residential status. For purposes of assessment, the gamut of taxation and scope of total income depend upon [i] the residential status of the assessee [*See pages 26 to 32*]; [ii] the place of accrual or receipt of income—whether *actual or deemed; and (iii) the point of time at which the income had accrued or was received.*

Thus the incidence of tax, *i.e.*, the ambit of total income of the assessee, would be as under :

A. Resident [and ordinarily resident] :—The total income in the case of residents would consist of :—

[a] income received or deemed to be received in India during the accounting year irrespective of the date or place of its accrual [Section 5 [1] [a];

[b] income which accrues or arises or is deemed to accrue or arise in India during the accounting year, the date or place or receipt being immaterial [Section 5 [1] [b]; and

[c] income which accrues outside India during the accounting year, even if it is not received or brought into India [Section 5 [1] (c].

B. Resident (but not ordinarily resident) : The composition of total income in the case of a resident but not ordinarily resident would be the same as above *except* that in his case in the income accruing or arising outside India would be excluded unless (i) the income is derived from a business controlled or profession set up in India, [Proviso to Section 5(1)(c)]

C. Non-Resident :—A non resident's total income would include :—

[a] income received or deemed to be received in India in the accounting year, the place or date of its accrual being immaterial [Section 5[2] a].

[b] income which accures or arises or is deemed to accrue or arise in India during the previous year, the date and place of its receipt being immaterial [Section (2) (b)]

Thus all assessees, whether resident or not, are chargeable to tax in respect of their income accruing, arising or received or deemed to accrue, arise or to be received in India, while residents alone are chargeable to tax in respect of income which accrues or arises and is received outside India.

The expression 'total income' for this purpose includes also income which is includible in the total income but qualifies for rebate at the average rate of tax or for deduction from gross total income. The fact that a certain receipt is exempt from tax would not exclude the same from being included in the total income. Thus, the total income of an assessee is not necessarily subject to tax in full. In other words, the total income of an assessee may consist, in certain circumstances, of income which are totally exempt under Sections 10 to 13 and those which qualifies for

deduction or rebate under Sections 80A to 86A. All taxable income from whatever source derived by the assessee must be included in his total income.

5.2 **Income Received or Deemed to be Received :** All assessees are taxable in respect of the income received or deemed to be received by them in the previous year irrespective of their residential status The liabilities to tax depends upon the locality or place and, if the receipt is in India, it is taxable ; it is immaterial whether the income accrued or arose in India. If income is either received or deemed to be received in India, the whole of the income is taxable and there is no need to apportion it as may be necessary in the case of income which accrues or is deemed to accrue in India. Both actual and constructive receipts of income either by the assessee directly or by some one else acting on behalf would have to be included in the total income. Examples of such constructive receipts are : payment of income-tax, insurance premium and deduction of contributions to provident or other funds from the employee's salary by the employer, conversion of a debt into a fresh loan or deposit by a creditor, adjustment of the amount due from a person towards the payment to be made to him and exchange of one asset with another in the course of sale, transfer, *etc*.

The assessee would be presumed to have received the income at the first instance even if the same was received on his behalf by his bank, broker or agent since income cannot be received twice. Income is to be included in the total income immediately on its receipt or deemed receipt. But receipt of income is not the only test of its taxability; income would be taxable when once it becomes due to the assessee or in its accrual whether actually received or not. The taxability of a certain receipt as income would depend upon the method of accounting followed by the assessee. Thus, under the cash system of accounting an income is taxable only on its receipt by the assessee or on his behalf. But under the mercantile system an item of income would be taxable when once it falls due to the assessee whether actually received or not. In other words, where the accounts are maintained under the mercantile basis or hybrid system, the date of taxability of income is the date when the appropriate entries are made or should have been made in the books of account in accordance with the method of accounting regularly employed by the assessee. In the case of salary and interest on securities the liability to tax arises as soon as the income falls due to the assessee. In the case of dividends, it will have to be included in the total income of the shareholder in the year in which the dividends were actually declared. In the case of interim dividends it would be included in the total income of the year in which such dividends are unconditionally made available to the shareholders.

The date or time of receipt of income is very important if the assessee's accounts are maintained on cash basis since the income could be included in the total income only if it is received by him during the accounting year. However, it should be noted that methed of accounting determines only the date of taxability of the income but not the date or place of the receipt or the nature of the income.

5 3 **Income deemed to be received** [Section 7] : In addition to the general discussion given above, Section 7 specifically provides that the following items of income shall be

deemed to be received by the assessee during the previous year irrespective of the fact whether he had actually received the same or not :

[i] the annual accretion in the previous year, to the balance standing to the credit of an employee participating in a recognised provident fund to the extent provided in rule 6 of Part A of the Fourth Schedule.

[ii] the transferred balance in a recognised provident fund to the extent provided in Rule 11 (4) of Part A of the Fourth Schedule

5.4 **Distinction between the terms "accruing" "arising" and "received"** : The words "accruing" and "arising" are used in contra-distinction to the word 'receive' and indicate "the right to receive". Income accrues at a point of time prior to its quantification or computation which is not a condition precedent to its accrual. For example, interest on Government securities is usually payable on specified dates, say 1st January and 31st July. In such cases the interest is said to accrue from 1st July to 31st December and on 1st January it will fall due for payment. Income can be said to accrue or arise only in cases where accrual of the income is certain e.g., interest on securities. The world "accrue" and "arise" though synoymous do not mean the same thing as far as the date is concerned. In other words, income which accrues in the previous year may not also arise in the previous year, mostly in cases where the assessee follows a hybrid system of accounting. Income is said to accrue when it first comes into existence or the right to receive the same comes into being but it is said to arise only when the method of accounting shows it in the shape of profit or gains While considering the question of accrual of income it is also essential to ascertain the time of accrual, the person to whom it accrues and the place of accrual and treat the income accordingly. For this purpose, income is said to have accrued only when the assessee acquires a right to receive the same. Income can be said to accrue only to the person who is entitled to claim it on the date of its accrual. As for the place of accrual, income is said to accrue at a place where the contract yielding the income entered into and for this purpose the contract is said to have been entered into at a place where the offer is accepted. Income is said to accrue at the place where the business is carried on or the source of income is situated. The place of accrual or receipt of income is important mostly for the assessment of non-residents.

5.5 **Income deemed to accrue or to be received in India** : This phrase means that income does not actually accrue or is not received in India but still, the statute, by a fiction of law, requires or treats the same as having accrued to or having been received by the assessee in India. Thus this phrase denotes accrual or receipt statutorily or fictionally as against accrual or receipt in replity. This phrase implies that the income : —

(i) does not accrue or it is not received at all in reality : or

(ii) in fact accrues or is received but not in India ; or

(iii) is deemed to be the income of the assessee though in reality it is the income of someone else ; or

(iv) is deemed to be the income of the previous year (*i.e.*, the accounting year) where it may actually be the income of a different year.

In other words, this phrase provides for the artificiality of income in regard to the time and place of accrual or receipt, the chargeability of a person other than the actual owner of the income and the year of taxability. Thus, income accruing or arising in a foreign country in the name of another person at a different point of time, may be deemed to be the income of the assessee during the previous year.

However, the foreign income of an assessee would not be deemed to have accrued or been received in India and consequently not includible in his total income if *all* the four conditions given below are satisfied :

(i) The assessee is a person resident but not ordinarily resident in India.

(ii) the income accrues or arises to him outside India.

(iii) It is not deemed to accrue or arise in India, nor is it received or deemed to be received in India.

(iv) It is not derived from a business controlled from or a profession set up in India.

In the case of non-resident assessee the total income would consist of (i) income received or deemed to be received in India even if it accrues elsewhere, and (ii) income which accrues or is deemed to accrue or arise in India even if it is received elsewhere. Non-residents are assessable on their total income at the rates applicable to them regardless of their other foreign income or the total world income. Where a business of an indivisible nature is carried on by a non-resident in many countries the profit attributable to the business operations carried out in India alone would have to be included in his total income.

Where the assessee is a firm the residential status of any of its partners is immaterial for the purpose of ascertaining the residential status and consequently the total income of the firm. Therefore, a non-resident partner of registered (or unregistered) firm cannot exclude from his total income a proportion of his share of the firm's income corresponding to that portion of the firm's income which accrued or arose to it outside India.

However, Explanation 1 to Section 5 further clarifies that in all cases where income actually accrues or arises outside India it shall not de deemed to be or to have been received in India merely because of the fact that it has been included in the accounts and balance sheet prepared in India. This is because of the fact that no amount of book keeping entries or entries in the books of account kept in the home country would be equivalent to the receipt foreign income abroad. Even in case where the foreign income is not only included in a balance sheet prepared in India but is also included in the profit and distributed as dividends the foreign income cannot be deemed to have been received in India. Thus, whether a certain income can be deemed to be received in India or not would depend primarily upon acts of the case. This provision is intended to remove the difficulties and the doubt which would otherwise arise in determining the total income of a client.

Explanation 3 specifically provides that when once an item is included in the assessee's total income and subjected to tax on the ground on accrual or receipt, it cannot again be included in the person's total income subjected to tax either in the same year or in a different year on the ground of its receipt, whether actual or deemed. But whether an assessee should be assessed on accrual basis or receipt basis would depend primarily upon the method of accounting regularly employed by the assessee.

The Supreme Court held recently in *C.I.T. v. Toshoku Ltd* [1980]4 Taxman-1 that mere making of book entries in the books of statutory agent of a non-resident would not amount to receipt by the non resident, as the amounts so credited in their favour were not at their disposal or control. Such credit balance merely represents a debt and a mere entry in the debtor's own books does not constitute payment which will secure discharge from that debt. In such cases, the non-resident could not be charged to tax on the basis of receipt of income, actual or constructive to the taxable territories during the relevant accounting period. However if the making of book entries is in pursuance of specific terms governing the mode of payment and the amounts so credited by book entries are at the disposal of the non-residents a liability of tax would arise on the basis of constructive receipt—vide *Raghava Reddiar.* v. *C.I.T. (1962) 44 I.T.R 720 (SC).*

6. **RESIDENCE** (Section 6)

This Section specifies two alternative tests of residence for individuals, two for companies and one for Hindu undivided families, firms, associations of persons and other taxable entities. For all purposes of income-tax all assessees are grouped under three broad categories : *viz*

(i) resident (also called resident and ordinarily resident) ;

(ii) resident but not ordinarily resident ; and

(iii) non-resident.

An assessee's residential status has to be ascertained with reference to the period (not the purpose) of his stay in India in the previous year or the accounting year but *not* the assessment year. Further, the residential status of the assessee has to be determined with reference to each accounting year and for this purpose it is not correct to assume that a person who is reisdent in one year would continue to be so in the succeeding years as well. This is because of the fact that a person who is resident in one year may become non-resident or not ordinarily resident in India in another year or *vice versa*.

6.1 **Individuals** : An individual is said to be resident in India in any previous year if he—

(a) has been in India during that year for a total period of 182 days or more; or

(b) had been in India during the four years immediately preceding that year for a total period of 365 days or more *and* has been in India for at least 60 days in that year.

This period of 60 days is varied in two cases. If an Indian citizen, being outside India, comes on a visit to India during the said previous year has to be 90 days instead of 60 days. It is to be noted that earlier this was applicable to an Indian citizen rendering service outside India and coming to India on leave or vacation during the particular previous year. By an amendment, the Finauce Act, 1982, has extended the concession to all Indian citizens who are outside India—either on employment or vocation or otherwise, and who come to India on a visit for any purpose during the previous year.

The second case where the period of 60 days does not apply has also been brought about by an amendment made by the Finance Act, 1982. This arises where an Indian citizen leaves India during the previous year for the purposes of employment outside India Here the minimum period of stay during the particular previous year has to be 182 days instead of 60 days, in order to become a resident assessee. The above changes are applicaple with effect from assessment year 1983-84.

The satisfaction of any one of the tests is enough. In both the tests the common factor is that the individual's personal stay in India during the previous year is essential though for different number of days If the individual has been staying continuously outside India during the whole year, he must be treated as a non-resident for that year. The period of stay required in this Section is not continuous or consecutive. It is also not essential that the stay should be at the usual place of residence, business or employment of the individual. What is required is that individual should have been in India in the previous year, the place and duration of his stay at each place being immaterial. Even stay on a ship or boat moored in the territorial waters of India would be enough. *The residence of an individual for income tax purposes has nothing to do with his citizenship, place of birth and domicile.* According to this Section an individual may be resident in two countries in the same year, though he can have only one domicile.

6.2 Hindu Undivided Family, or other Association of Persons ; A H.U.F. firm, or other association of persons would be resident in India, if the control and management of its affairs is situated wholly or partly in India. As a result, only when the control and management of the affairs is situated *wholly* outside India the assessee would become a non-resident In view of the fact that even a partial or even negligible control is enough to make the assessee a resident, a firm may sometimes have two places of residence. For purpose of determining the residential status of a firm or a Hindu undivided family, the residential status of the partners of the members of the family is immaterial, except in cases where the residence of the partners or the members materially affects its control and management. The mere fact that all the persons are residents in India need not necessarily imply that the firm is also resident in India because its entire control and management may be exercised from outside India. The control and management of a business is said to be situated at place where the "head and brain of the adventure" is situated; the place of control may be different from the useful place of running the business or even, sometimes, the registered office of the assessee, because control of a business need not necessarily mean the carrying on of a business. Control and management,

however, implies the functioning of the controlling and directive power at a particular place with some degree of permanence.

A Hindu undivided family is ordinarily presumed to be resident in India except in cases where the assessee proves that the control and management of its affairs is situated wholly outside India The word "affairs" is used in this context to mean the assessee which are relevant for tax purposes and which have some direct or indirect relationship to the income sought to be assessed. If the seat of management and control is divided and is exercised from more places than one, then the family may have more than one residence. But where the entire control and management of the affairs of the Hindu undivided family is exercised from outside India though a part or whole of the business is carried on in India, even occasional visit of the non-resident Karta to the place of business or casual directions given by him at the time of his visits, would not make the family a resident in India. However, the absence of the Karta from India throughout the previous year would not, on the other hand, make the family a non resident since the business of the family may be controlled by someone else during the absence of the Karta. Also, in a case where a coparcener of the Hindu undivided family representing the family is a partner of a firm carrying on a business controlled in India the control and management of the family's affairs cannot be said to have been exercised from within India merely because the coparcener is a partner in the firm representing the family. In this context the expression, control and management used in this Section denotes the *de facto* (but not *de jure*) control and management and not the mere right to control and manage. Thus the acts of actual control and management of the affairs of the assessee but not the mere receipt of copies of account books in India by the Karta or the partner.

6.3 **Companies** :—A company is said to be resident in India if—

(i) it is an Indian company as defined in Section 2 (26) ; or

(ii) the control and management of its affairs is situated wholly in India during the accounting year.

Accordingly, every Indian company is deemed to be resident in India even if the control and management of its affairs is situated wholly or partly outside India. But a non-Indian company would become resident in India *only* if its control and management of the affairs of the non-Indian company is situated outside India, it would be a non-resident. A foreign company will be resident in India if its control and management is exercised wholly in India. A company may have more than one resident but the fact that it is resident elsewhere also would not *ipso facto* affect its residential status in India.

The two conditions specified for testing residential status of companies are alternative in their application. In contra-distinction to the test of residence in the case of a Hindu undivided family or a firm where the assessee would be resident in India even if a negligible part of its affairs is controlled from within India, a non-Indian company would become resident in India only if its control and management is situated *wholly* in India. Thus, a non-Indian company whose affairs are controlled wholly or partly from abroad would be non-resident for income-tax purposes.

The expression 'control and management' in relation to companies means the head, seat and directing power of the company's affairs. Hence the control and management of the affairs of a company are said to be exercised from the place where the meetings of the Board of Directors are held, decisions taken and directions issued. The residential status of the directors or the normal place of carrying on of the business is immaterial.

A company may change its place of control and management in any year and as a result the residential status of the company may also change. Therefore the residence of non-Indian company may have to be determined with reference to each previous year due to the fact that a company which is resident in one year need not necessarily be resident in the next year or years.

6.4. Other Assessees : The residential status of other taxable entities such as local authorities and artificial juridical persons (*e.g.* statutory corporations, idols, deities) would have to be ascertained by applying the test (6.2) above applicable to a Hindu undivided family, firm or other associations of persons.

> *Note* : If an assessee is resident in a previous year in respect of any one of his sources of income, he would be resident in the previous year in respect of all his sources of income. That is only in cases where the assessee cannot be said to be resident in India in respect of any of his sources of income taxable in India, he would be a non-resident in India.

Resident and Ordinarily Resident : Individuals and Hindu undivided families who satisfy any of the tests applicable to them (as stated above) must, in order to be resident and ordinarily resident in India, in addition, satisfy either of the following conditions as well :

An individual would be resident and ordinarily resident in India only if (i) he had been resident (as stated above) in India in nine out of the ten preceding years ; and (ii) had, during the seven years preceding that year been physically present in India for a total period of not less than 730 days.

In other words, if the individual does not satisfy both or any one of these conditions he would be resident but not ordinarily resident in India. A new-comer to India would be a not ordinarily resident for the first nine years of his stay in India and an ordinarily resident individual would on his return become a not ordinarily resident if he stays outside India or remains non-resident in India for two years.

A Hindu undivided family is deemed to be resident and ordinarily resident in India if its manager or Karta is resident and ordinarily resident in India according to the tests applicable to individual. For this purpose the periods of stay of successive managers of the Hindu undivided family in India during the continued existence should be added up.

> *Note* : Only an individual or a Hindu undivided family can be resident, not ordinarily resident or non-resident in India. All other assessees can be either resident or non-resident but cannot be not ordinarily resident for purposes of taxation.

7. YEAR OF TAXABILITY OF DIVIDEND INCOME (*Section 8*) :

7.1 **Final Dividends** : According to this Section dividends (other than interim dividends) shall be chargeable to tax in all cases as the income of the previous year in which they are declared In other words, ordinarily dividend should be treated as the income of the year in respect of which they are declared The rationale behind treating dividends the income of the year of their declaration is that the shareholders get the rights of claim dividend from the company only upon declaration. The actual date of receipt being immaterial for tax purposes, the year of taxability of dividends may be different from the year in which the dividends are paid or are payable. Thus, arrears of dividends for the past years, declared by a company in one accounting year, are all taxable as the income of the year of declaration regardless of the fact that dividends relate to different previous years and are of different amounts. In other cases of dividends amounting to distribution of the accumulated profits of company, the year of taxability would be the year of actual distribution (though not necessarily the date of receipt of the distributed amount by the shareholders).

7.2 **Interim Dividends** : Interim dividends, however, are taxable as the income of the previous year in which the amount of such dividends is unconditionally made available by the company to the shareholders who are entitled thereto For this purpose a resolution by the Board of Directors to pay a certain amount as interim dividends does not create a debt enforceable against the company. Therefore, interim dividends are to be charged as the income of the previous year in which the dividend warrants are actually issued. The year of taxability of the interim dividends has to be determined in all cases without regard to the method of accounting followed by the assessee.

8. INCOME DEEMED TO ACCRUE OR ARISE IN INDIA (*Section 9*) :

8.1 **Meaning** : Under the Section certain types or items of income are artificially deemed to accrue or arise to the assessee in India even though they may accrue or arise outside India The Section operates only to shift the place of income to India but not shift the ownership or title of the assessee to that income. The Section applies to all assessees irrespective of their residential status, citizenship, domicile, place of residence of business, nationality or relationship with persons in India. But this Section does not apply to cases where the income actually accrues or arises or is received or deemed to be received in India. Since income which is deemed to accrue or arise in India is taxable in the hands of assessees irrespective of their residential status, the implications of this Section are of very great importance and this is much more so in the case of non residents and persons who are not ordinarily resident who, in the absence of this Section, would be exempt from tax on their income accruing or arising outside India.

According to this Section the following types of income shall be deemed to have accrued or arisen in India :

(1) any income arising outside India in certain circumstances specified in clause (i).

Under clause (i) of the Section income is deemed to accrue or arise in India if it accrues to the assessee abroad directly or indirectly —

(a) through or from any business connection in India; or

(b) through or from any property in India; or

(c) through or from any asset or source of income in India; or

(d) through the transfer of a capital asset situated in India.

This clause applies to resident and non-resident assessees alike though it does not apply to income which actually accrues or is received in India. In its application to non-residents, who are assessable through their representative assessees under Sections 160 and 161 this clause (i) applies to the income of the non-residents alone but their agents, and (ii) specifies the four categories of income stated above in respect of which the agent is vicariously liable irrespective of the fact whether the income actually accrues or has been received in India.

(2) Income from 'Salaries' (i) which is earned in India, or (ii) which is payable by the Government to an Indian citizen for services outside India.

(3) Dividends by an Indian company outside India

(4) Income by way of

(a) Interest

(b) Royalty and

(c) Fees for technical services.

Under specified circumstances. The circumstances are explained subsequently.

8.2 **Income Arising from Business Connection** : For purposes of clause (i) of sub-section (1) the expression 'business connection' has a meaning much wider than what is commonly understood by its usage: it is totally different from, though related to the carrying on of a business. The meaning of this expression should be taken to include—

maintaining a branch office, factory, agency, receivership or management for the purchase or sale of goods or transacting other business ;

(i) creating a factory where the raw material purchased locally is processed or converted into a form suitable for export abroad;

(ii) appointing any agents in India for the systematic and regular purchase of raw materials to other commodities or for the sale of the non-resident's goods or any other purpose;

(iii) forming a local subsidiary company to sell the products of the non-resident parent company;

(iv) close financial association between a resident and a non-resident company ;

(v) grant of a continuing license to a resident to exploit for profit an asset belonging to a non-resident even if the transaction may be disguised as an out and out sale.

The Supreme Court held in *Barendra Prasad Roy* v. *I.T.O., (1981) 6 Taxman 19* the expression 'Business Connection, in Section 9(1) and Section 163 are comprehensive enough to include all heads of income mentioned in Section 14 and that there is no warrant for giving a restricted meaning to it by excluding professional connections from its scope.

A business connection may exist even without any regular agency, branch or other organisation. Thus profits accruing to a non resident in foreign countries through work done in India by his agents here whose agency includes the business in those foreign countries also or profits arising to a non resident even from sales made by him directly on a principal basis on his agent who is a sole selling agent in India would be deemed to have accrued or arisen in India However, the mere fact that a substantial part of the goods produced by the non-resident is found in the markets in India or is sold directly or through brokers to various customers in India or mere rendering services outside India to a person carrying on business in India, or the mere canvassing of sales promotion activities by a commission agent in India with no authority to accept orders or to enter into contracts on behalf of the non-resident principal would not constitute business connection within the meaning of the clause. Further, a non-resident's trade with India is not to be treated as trade in India amounting to business connection In view of the above discussion all income accruing or arising to a non-resident by virtue of his business connection in India would be deemed to have accrued or arisen in India and would accordingly be taxable.

Exceptions

However, there are two exceptions to this rule which are stated in the explanations (b) and (c) to Clause (i) of this Section. According to this provision, which was introduced for the purpose of encouraging exports, no income shall be deemed to accrue or arise to a non-resident in India through or from operations which are confined only to the purchase of goods in India for purposes of export. However in the case of residents and not ordinarily residents since the purchase of goods for export purposes amounts to business connection in India, the profits, if any arising from such transactions would be deemed to accrue in India This is because of the fact that this exemption applies only to non-residents irrespective of the facts whether or not (i) the non-resident keeps an office or agency in India for the purpose or (ii) the goods, before their export, were subjected to a manufacturing process.

Clause (c) of the 'Explanation to Section 9 (1) (i), makes it clear that no income will be deemed to accrue or arise in India to a non-resident engaged in the business of running a news agency or publishing newspapers magazines, or journals from activities confined to collection of news and views in India for transmission out of India. This Explanation was inserted by the Finance Act, 1983, with retrospective effect from 1st April, 1962.

8 3 Income from Property, Asset or Source of Income : The word 'property' used in this clause includes both movable and immovable property of any kind but does not, however, include intangible assets like goodwill, a debt or a chose-in-action. Income

arising abroad from or through the property (*e.g.* hire or rent for the use of the machinery or buildings of the assessee which under an agreement, are payable outside India) shall be deemed to accrue or arise in India But the income from intangible assets would also be deemed to accrue in India (*e g* , interest on loan or price for the use of goodwill payable) in view of the fact that intangible assets would fall within the meaning of the phrase 'any asset or source of income'.

8.4 **Income from the Transfer of a Capital Asset** : Capital gains arising to the assessee from the transfer of capital asset [as defined in Section 2 (14)] situated in India would also be deemed to have accrued or arisen in India. For this purpose it is immaterial whether—

(i) the capital asset is movable or immovable, tangible or intangible ;

(ii) the place of registration *etc* , of the document of transfer is in India or outside; and

(iii) the place of payment of consideration is in India or outside.

8.5 **Allocation of Profits** : Explanation (a) to the Section provides for the allocation of profits in respect of the different operations of a single business. Thus, where some of the operations of a business are carried out in India and some outside, the profits of the business should be apportioned between the profits attributable to both the sets of operations and only that portion of the profits which can reasonably be used in India. For instance, such an apportionment will be necessary in cases where the goods are manufactured in one place and sold in another and in such a case the profits will have to be apportioned between the manufacturing and selling operations. Activities which are not well defined or are of a casual or isolated nature need not be taken into account for the purposes of allocating the profits between the various operations of the business. The apportionment of profits for purposes of this Explanation should be made on a rational basis but not arbitrarily. Under Rule 10 of the Income-tax Rules, 1962 in case where the income attributable to operations carried out in India could not be definitely ascertained, the amount of such income for assessment may be calculated —

(i) as such percentage of the turnover so accruing or arising as the Income-tax Officer may consider to be reasonable having regard to the facts and the circumstances of the case, or

(ii) on any amount which bears the same proportion to the total profits and gains of the business of the assessee computed in accordance with the provisions of the Act as the receipts so accruing or arising bear to the total receipts of the business; or

(iii) in such other manner as the Income tax Officer may deem suitable.

8.6 **Income from Salaries** : (a) Income chargeable under the head 'Salaries' is deemed to accrue or arise in India if it is earned in India. In other words, salaries for services rendered in India would be deemed to accrue in India and for this purpose the place of receipt or actual accrual of the salary is immaterial. An exception to this rule is, however, given in sub-section (2) according to which pension payable outside India by the Government to certain categories of Government officials such as judges who

permanently reside outside India, are not to be deemed to accrue in India. Thus, under clause (ii) non-residents and not ordinarily residents receiving salary or pension earned in India would be deemed to receive the income which has accrued in India, even if the income actually accrues or is received abroad. These provisions apply also to salaries paid by foreign governments or bodies to their employees serving in India.

The Explanation to Section 9 (1) (ii) added by the Finance Act, 1983 with retrospective effect from 1st April, 1979, clarifies that the income chargeable under the head 'salaries' payable for services rendered in India, will be regarded as income earned in India. This Explanation supersedes the Gujarat High Court's decision in C.I.T. v. S G.P. Gratala (1980) 124 ITR 391 to the effect that if the liability to pay the salary arises outside India and the salary is also payable outside India, the same could not be deemed to accrue or arise in India even if the services are rendered in India.

(b) Similarly, salaries payable by the Government to a citizen of India in respect of services rendered outside India would be deemed under clause (iii) to have accrued in India regardless of the place of actual receipt of the salary, or the place of its actual accrual. Thus, salaries received by Government servants abroad, who after sometime would become non-residents, would be deemed to accrue in India and consequently cannot escape income tax in India In such cases the allowances, perquisites or other benefits paid or allowed by the Government outside India are not to be taken into account for this purpose since they are totally exempt from tax under Section 10 (7). Salaries paid by the Government to citizens of other countries cannot, however, be deemed to have accrued in India because this clause applies only to salaries payable by the Government to Indian citizens for their services in a foreign country.

8.7 **Dividends** : In all cases dividends paid by an Indian company outside India shall be deemed to accrue in India under clause (iv) and for this purpose the place at which the shares yielding the dividends (*i.e.*, the place where the share register is kept) is irrelevant. In other words, dividends declared abroad and payable abroad would not ordinarily accrue in India even though the company may be Indian and the *situs* of the shares may be in India. But such dividends would be deemed to accrue in India under this clause by reason of the fact that dividends are declared by an Indian company or under clause (i) since the shares constituting the source of the dividends are situated in India Therefore, all shareholders whether resident, non resident or not ordinarily resident and whether they have actually received the dividends or not, would be liable to tax on their dividends income from Indian companies. The provisions of this clause cannot be so interpreted as to deem the dividends declared by a foreign company as accruing in India even if the foreign company is resident in India by virtue of the control and management of its affairs be situated in India. This is because of the fact that this clause applies only to dividends declared by Indian companies and foreign companies cannot become Indian merely by reason of their residence in India.

8.8 **Interest** : According to clause (v) of sub-section (1) of Section 9 of the Income-tax Act, any income by way of interest payable by the Government or by any person

who is resident in India would be deemed to accrue in India. In case where the interest is payable by any resident taxpaper in respect of any debt incurred or money borrowed and used either for the purpose of a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source *outside India*, it would not be deemed to accrue in India by virtue of the exception specifically provided under sub-clause (b) of clause (v). Similarly, the interest payable by any person who is a non-resident in India would also be deemed to accrue or arise in India in cases where the interest is payable in respect of any debt incurred or money borrowed and used for the purpose of a business or profession carried on by the non-resident in India. In all the three cases mentioned above it is essential that the term "interest" must be taken to have some meaning as is given to it under Section 2 (28 A).

8.9 **Royalties** : Under clause (vi) of the sub section (i) of Section 9, income by way of royalties payable by the Government would be deemed to accrue in India in every case and would consequently be assessable to tax in the hands of the assessee. Even in cases where the royalty income is payable by any person who is a resident in India it would be deemed to accrue in India and would be subjected to tax. However, where the royalty is payable in respect of any right, property or information used or services utilised either for the purposes of a business or profession carried on by the resident *outside India*, or for the purposes of making or earning any income from any source *outside India*, the royalty would not be deemed to accrue in India by virtue of the exceptions specifically provided in sub-clause (b) of clause (vi). The income by way of royalty payable by a non resident would also be deemed to accrue in India in cases where the royalty is payable in respect of any right, property or information used or services utilised for the propose of a business or profession carried on by the non-resident in India or for the purpose of making or earning any income from any source in India.

However, the aforesaid provisions for treating royalty income as being deemed to accrue in India would not apply in relation to so much of the income by way of royalties as consists of lump sum consideration for the transfer outside India of or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade-mark of similar property, if such income is payable in pursuance of an agreement made *before* 1st April, 1976 and that too, *only if* the agreement is approved by the Central Government For this purpose, an agreement made on or after 1st April, 1975 would be deemed to have been made prior to that date if the agreement is made in accordance with the proposals approved by the Central Government prior to 1-4-1976. In cases where the recipient of the income by way of royalty is a foreign company, the agreement would not, however, be deemed to have been made for 1-4 1976 as mentioned earlier *unless* the foreign company exercises an option by furnishing a declaration in writing to the Income-tax Officer to the effect that the agreement that is approved by the Central Government on or after 1-4-1976 may be regarded as an agreement that was made prior to 1-4-1976. The option must be exercised in writing by the foreign company before the expiry of

the time allowed under Section 139 (1) or (2), whether fixed originally or on extension, for furnishing the return of income of the foreign company for the assessment year 1977-78 or for the assessment year for which the royalty income becomes first chargeble to tax in India, whichever assessment year is later. The option once exercised becomes final.

For purposes of being subjected to tax as income deemed to accrue or arise in India, the term '*royalty*' must be taken to mean any consideration including any lump sum consideration for –

(i) the transfer of all or any right, including the granting of licence, in respect of any patent, invention, model, secret formula or process or trademark or other similar property;

(ii) the imparting of any information concerning the working of use of the above assets;

(iii) the use of any of the above items of properties;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience and skill;

(v) the transfer of all or any of the rights (including the granting of a licence) in respect of any copyright literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for being used in connection with radio broadcasting but not, however, including the consideration for the sale, distribution or exhibition of cinematographic films ; or

(vi) the rendering of any services in connection with activities referred to in any of the items (i) to (v) mentioned above.

It may however, be noted that any consideration in respect of any of the above items of assets which would be the income of the *recipients chargeable to tax under the head 'capital gains' would not fall within the scope of the term 'royalty'* and would not, therefore, be deemed to accrue or arise in India under Section 9 (1) (vi).

8.10 Fees for Technical Services : Clause (vii) of sub-section (i) of Section 9 of the Income tax Act provides that income by way of fees for technical services paid or payable by the Government would be deemed to accrue or arise in India in every case regardless who the recipient is and whether the technical services are rendered in accordance with an agreement approved by the Central Government or not. Fees for technical services paid or payable by any person who is a resident in India would also be normally deemed to accrue or arise in India; however in cases where the fees are payable in respect of services utilised in any business or profession carried on by the resident outside India or for the purpose of making or earning any income from any source outside India, the fees so payable would not be deemed to accrue in India in view of the specific exemption provided under sub-clause (b) of clause (vii). In cases where the fees for technical services are paid or payable by a non-resident, the income would be deemed to accrue or arise in India only if the fees are payable in respect of

services utilised in a business or profession carried on by the non-resident in India or for the purpose of making or earning any income from any source in India

In other words, the provisions of Section 9 (1) (vii) would not operate in those cases where foreign concerns had entered into an agreement and had finalised the proposals for rendering technical services with the approval of Central Government on the understanding that such payments would be exempted from income-tax. Thus, income by way of fees for technical services payable in pursuance of an agreement made before first April, 1975 and approved by the Central Government would not be deemed to accrue in India and consequenty would not be chargeable to tax unless such income is received in India by or on behalf of the non-resident to have been made on or before 3 st March, 1976 if the agreement is entered in accordace with the proposals approved by the Central Government on or before 31st March, 1976 would be applicable even in those cases where the fees for technical services arise to the foreigner by virtue of the agreement In other words, the provisions similar to those for granting tax exemption in respect of royalties in certain categories of agreements entered into on or before 31st March 1976 or in respect of proposals which were approved by the Central Government on or before th t date would apply to grant exemption to the assessee in respect of fees for technical services as well. This is made clear by the Explanation 1 to Section 9 (1) (vii)

For this purpose the expression "*fees for technical services*" must be taken to mean any consideration (including any lump sum consideration) for the rendering of any managerial, technical, or consultancy service including the provision of services of technical or other personnel; the meaning of this expression would not however, included : (i) any consideration for any construction, assembly, mining or like project undertaken by the recipient and also (ii) any consideration which would be the income of the recipient chargeable to tax under the head 'salaries'.

9. INCOMES NOT INCLUDED IN THE TOTAL INCOME (Section 10)

The various types of incomes enumerated under this Section are entirely to be excluded from the computation of the taxable income or the total income of an assessee. In other words, they are not to be taken into consideration for purposes of determining either the taxable income or the rate of tax. The benefit of these exemptions would be available to the assessee in respect of these incomes even if such incomes are deemed to the assessee's income by virtue of any of the provisions of the Act *e.g.*, income of other persons included in the assessee's total income under Sections 60 to 65. The exemptions given under this Section to certain types of incomes are based upon the nature of the income and the character of the recipient asssessee. Certain types of incomes which are partly or wholly exempt and not covered by this Section are discussed later in Study Papers IV and V. However, the fact that a certain receipt is exempt under this Section does not mean that but for the exemption it would necessarily be taxable This Section provides exceptions to Section 5 which determines the scope of total income of assessee. By virtue of the provisions of this Section the total income of an assessee cannot include the various items of incomes specified therein irrespective of the place of accrual or receipt of these

items of income The exemptions granted under the different sub-sections are, however, subject to the conditions specified therein.

9.1 **Agricultural Income** : According to Section 10 (1) any receipt from lands which falls within the meaning of the expression 'agricultural income' as defined in Section 2 (1) is exempt from tax. The meaning of this expression has been discussed in the beginning of this Study Paper. This exemption would be available in all cases of agricultural income, however, and by whomsover it is received. But (i) income from the sale of wild grass or forest of spontaneous growth, (ii) rent of the site of a flour mill, (iii) income from land used for potteries, brickfields, stone-quarries, salt-pans or for standing crops, grains or timber, (iv) ground rent for permanent shops at bazars or fees for installing temporary stalls and shops on the land, (v) compensation received for the land requisitioned by the Government, and (iv) income from fisheries, not being agricultural in nature, are not covered by the exemption under this Section.

The net agricultural income of individuals, Hindu undivided families, unregistered firms, associations of persons, bodies of individuals and other artificial juridical persons is to be taken into account for determination of the rate of tax to be applied to their total income if such total income exceeds the minimum limit i.e , Rs. 15,000 with effect from the assessment year 1982-83. Registered firms or unregistered firms which are assessed as registered firms under Section 183(b) of the Income-tax Act who are chargeable to tax under the Income-tax Act or whose income so chargeable does not exceed the basic exemption limit are outside the purview of this provision.

The rules for computing the net agricultural income of any non-corporate tax-payer as laid down in Part IV of the First Schedule to the Finance Act, 1979 have been discussed in Study IV.

The tax is to be calculated in the following manner :

(i) The agricultural and non-agricultural components of the tax-payer's income will first be aggregated and income tax calculated on the aggregate as if such aggregate were the total income :

(ii) Income-tax will then be calculated on the net agricultural income as increased by an amount of Rs. 15,000 (*i.e.*, the first slab of income on which tax is charged at nil rate) as if such increared net agricultural income were the total income ;

(iii) The amount by which the income-tax calculated under (i) exceeds the amount calculated under (ii) above, will be the income tax payable by the tax payer on his total income.

The income-tax as determined under (iii) shall be increased by a surcharge at the rate of 10% (12.5% with effect from the assessment year 1984-85) of such tax.

9.2 **Payments by a Hindu Undivided Family to its Members** : Members of a Hindu undivided family do not have to pay tax in respect of the amounts received by them from the family. This exemption applies only in respect of payments made by the Hindu undivided family to its members (i) out of the income of the family or (ii) out of the income of the holder of an impartible estate belonging to the family. This

exemption cannot be denied to the assessee on the ground that the family or the holder of the impartible estate has not paid the tax on the income out of which the payment is made. In order to claim this exemption the assessee should be a coparcener; the nature, frequency and purpose of the payment are immeterial. The exemption is not available in respect of payments made by any of the members of the family or other members even if the payments can be traceable to the income of the family. The assessee cannot also claim the benefit of this exemption when once he ceases to be a member of the Hindu undivided family on account of partition in the family or the death of the assessee himself. The exemption in respect of payments out of the income of the impartible estate would not be available if the estate does not belong to the family or if the amount is not received out of the estate by the holder from the estate or if the amount is not received by the assessee in his capacity as a member of the Hindu undivided family. But where the member lives apart, he or she would still be entitled to this exemption because living apart or in separation does not mean that the person has ceased to be a member of the Hindu undivided family. This exemption is, however, subject to the provisions of Section 64 (2) explained later in this study.

9.3 **Receipts of a casual and non-recurring nature :** Receipts which are of a casual and non-recurring nature are exempt from tax *if* all the following four conditions are satisfied.

(i) the receipt should, in reality, be of a casual and non-recurring nature ;

(ii) it should not be capable of being brought within the meaning of capital gains which are chargeable to tax under Section 45 ;

(iii) it should not arise from any business on the exercise of a profession, vocation or occupation ; and

(iv) it should not be by way of any addition to the remuneration of an employee.

(v) it should not constitute winnings from lotteries ; and

(vi) the aggregate of the casual receipts [other than items (ii) (iii) (iv) and (v)] should not exceed Rs 1,000

In order that the exemption is available the receipt in addition to its being of revenue nature should be *both* casual and non-recurring. If the receipt though casual, is recurring in nature the exemption would not be available. Example of casual and non-recurring receipts are : lotteries, prizes, awards, income from horse race, quiz, betting *etc*, gifts received on the occasion of birth day, marriages or similar occasions (even if they are received at a regular interval of time), amounts received for acting as an arbitrator without any stipulation as to remuneration, fee for the issue of fresh share capital, profit on sale of silver or gold not held as a business or capital asset, *etc*. However, interest received by a decree holder under an order of the Court for staying the execution of a decree or interest received under an award of decree of any Act, compensation for compulsory acquisition of business premises by the Government, refund of the taxes or estate duty wrongly received etc., cannot be called receipts of casual and non-recurring nature and hence, would not be exempt from tax.

It may be recalled that the term 'income' includes in its scope incomes such as winning from lotteries, crossword puzzles, races including horse races, card games, other games of any sort or from gambling or betting. Winnings from lotteries (although they are of a casual and non recurring nature) would not be covered by Section 10 (3) in view of the specific provisions for their concessional tax treatment under Section 80TT in the case of non-corporate assessees. Other items of casual receipts (not being additions to the remuneration of an employee, profits of a business or profession and capital gains) would be exempt from tax subject to a maximum monetary limit of Rs. 1,000 in the aggregate. The excess over the limit of Rs 1,000 would be taxable as 'income from other sources'.

9 4 Interest Received by a Non-Resident : Under clause (4) of this section any income from interest on or from the premium on redemption of certain securities specified or bonds issued by the Central Government would be exempt provided that the interest income belongs to and is assessable in the hands of a non-resident. The bonds or securities, the interest thereon is exempt from tax, should have been issued : (i) by the Central Government under a loan agreement with the International Bank for Reconstruction and Development or with the Development Loan Fund of U S.A ; or (ii) by an industrial undertaking or financial corporation in India under a loan agreement with the International Bank for Reconstruction and Development or the Development Loan Fund of U S A. with the guarantee of the Central Government.

Under clause (4A) any income from interest on moneys standing to the credit of a non-resident in a Non resident External Account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1947 or any Rules made thereunder would be exempt from tax. This exemption will be confined only to interest on funds repatriable outside India. Both these exemptions, however, would not be available to persons who were resident in India during the previous year.

Amendments made by the Finance Act, 1982. The Finance Act, 1982 has inserted a new clause (4A) in Section 10 of the Income tax Act. This new clause seeks to provide with effect from 1st April, 1982 that the exemption in respect of interest on monies standing to the credit of non-resident in a Non resident (External) Account in any bank in India in accordance with the Foreign Exchange Regulations Act would be available to all assessees who are resident outside India as defined in Clause (q) of Section 2 of Foreign Exchange Regulation Act.

The Finance Act 1982 has also inserted a new clause (4B) in Section 10 with effect from 1st April, 1983. Under this provision in the case of an individual being a citizen of India or a person of Indian origin who is a non-resident, the income from interest of such saving certificates of the Central Government as may be notified by that Government in the Official Gazette will be exempt from income-tax provided such individual has subscribed to such certificates in foreign currency or other foreign exchange remitted from outside India through official channels

9.5 Passage Money and Leave Travel Assistance :

In the case of Indian Citizens : Amounts received by an employee from his

employer towards passage moneys of leave travel assistance would be exempt from tax under Section 10(5) if the following four conditions are satisfied :—

(i) The employee should be a citizen of India.
(ii) The employee must proceed on leave.
(iii) The journey should be to his home district in India.
(iv) The concession is granted to the employee, his spouse and children in accordance with the terms of employment.

[Section 10 (6)(i) provides for a similar exemption for an employee who is not a citizen of India in respect of passage moneys of assistance received by him, whether freely or at a concessional rate, from his Indian or foreign employer. In the case of non-Indian citizens the exemption is available in respect of the concession received of them only if the same is received in connection with his proceeding on leave out of India. *i.e.*, to his home country. The conditions other than (i) and (ii) specified above in case of Indian citizens should also be satisfied by the non-Indian citizens before availing of this exemption.]

In both the cases the exemption would be available irrespective of the fact whether the amount is actually received by the employee or not.

With effect from 1st April, 1975, the exemption from income-tax would also be available in respect of any travel cenecession or assistance provided by the employer for meeting the expenses on journeys performed by the dependent parents and brothers and sisters of the assessee if they are wholly or mainly dependent upon the employee concerned in addition to his/her spouse and children. This has been provided by inserting an Explanation to Section 10(5) to define the term 'family' as meaning the spouse and children of the individual and the parents, brothers and sisters of the individual or any of them wholly or mainly dependent upon the individual. However, the Central Board of Direct Taxes has been empowered to prescribe (having due regard to the travel concession or assistance granted by the Central Government to its employees) in the Income-tax Rules exception to the condition that the exemption from income-tax in respect of travel concession of assistance would be limited to the amount that would have been due to the assessee had he proceeded on leave or after retirement from service or after the termination of his service to his home district in India

According to Rule 2B of the Income-tax Rules introduced with effect from 1st April, 1975, the amount exempted under Section 10(5)(a)(ii) of the Income-tax Act on account of the value of the travel concession or assistance received by or due to the employee in connection with his proceeding on leave to any place in *India* may exceed the value of the travel concession or assistance which would have been received by or due to him in connection with his proceeding to his home district in India on leave in the cases and circumstances mentioned below :

1. Where the individual is entitled to the benefit of travel concession or assistance once in a block of four calendar years commencing from 1st January, 1974, the value of the travel concession or assistance actually availed of by the employee in each such block;

2. In cases where the individual is entitled to such travel concession or *assistance more frequently than once in any such block of four calendar* years, the value of the *travel concession or assistance which is availed of* by him in each block ;

3. *In cases where such travel concession or assistance* is not actually availed of by the individual during any such block of four calendar years, then the value of the travel concession or assistance, if any availed of by the individual during the first calendar year immediately following block of four calendar years would also be exempted.

(b) *In the case of Foreign Citizens* : Under Section 10(6)(i)(a) of the Income-tax Act the value of any free or concessional passage moneys received by or due to any individual *who is not citizen of India* from his employer himself, his or her spouse and children in connection with his proceeding to his/her home country out of India is wholly excludible in computing the taxable income of the foreign citizen in India. Similarly, the passage moneys or the value of any free or concessional passage received by or due to the foreign citizen from his employer or former employer for himself, his spouse and children in connection with his proceeding to his home country out of India after retirement from service in India or after the termination of his service in India, is also wholly exempt from tax by virtue of its exclusion from the taxable income of the assessee.

Clause (aa) of Section 10(6) (i) grants tax exemption in full to foreign citizens in respect of the passage moneys or the value of any free or concessional passage due or received by the individual from his employer for his children, whether dependent or not, having full time education at any educational institution outside India in connection with their proceeding to India during vacation. The level, nature and medium of education are equally irrelevant The child or children need not necessarily undergo education in the country of which the foreigner is a citizen. The tax exemption is available irrespective of the number of such children studying abroad and also regardless of the amount of money received from the employer.

9.6 Other items of remuneration payable to Non-Indian citizens : individuals who are non-citizens of India are exempt from tax in respect of their following receipts :

(i) Remuneration received by them in the capacity of an ambassador, high commissioner, envoy, minister, *charged' affaires*, commissioner, counsellor, or the secretary, advisor or attache of an embassy, high commission, legation or commission of a foreign State for rendering service in such capacity in India.

(ii) Remuneration received by them in the capacity of a *consul de carriere* (by whatever name called) of a foreign State for rendering service in such capacity in India.

(iii) Remuneration received by them in the capacity of a trade commissioner or other official representative in India not holding office as such in an honorary capacity of the Government of a foreign State for services rendered in such capacity.

(iv) Remuneration received by any member of the staff or any officials mentioned in (i) and (ii) above, provided that the member (a) is a subject of the country represented and (b) is not engaged in any other business, profession or employment in India.

In the case of persons falling under (iii) and (iv) above the exemption would be available only if the Indian citizens in similar capacities are given corresponding exemptions from tax in the foreign country. These exemptions are reciprocal in nature.

(v) Remuneration received by them in the capacity of an employee of a foreign enterprise for services rendered during their stay in India.

This exemption, however, would be available only if all the three conditions stated below are satisfied :

(a) The foreign enterprise should not be engaged in any trade or business in India.

(b) The period of stay of the individual in India should not exceed, in the aggregate, a period of 90 days.

(c) The remuneration received by him should not be liable to be deducted from the income of the employer chargeable to tax under the Act.

(vi) **Remuneration received by Employees and Consultants from Institutions Established for Philanthropic purposes :** According to the provisions of Clause (via) of sub-section (6) of Section 10 with effect from 1st October, 1975, the remuneration received by foreign citizens as employees or as consultants to any institution or association or a body established or formed outside India solely for philanthropic purpose would be totally exempt from tax. However, it is essential that the remuneration in such cases is received for services rendered by the individual in India to the association or institution in connection with such purposes. Further, for the purpose of tax exemption to the individual it is also essential that the institution or body and the purposes for which the services are rendered, must be approved by the Central Government.

(vii) **Remuneration Received by Technicians :** Foreign Technicians whose services commenced prior to 1-4-1971 are governed by sub clause (vii) of Section 10(6). Since these provisions have got only academic importance and limited application now they have not been discussed here.

Technicians Whose Services Commence on or after 1-4-1971 : These technicians are governed by the provisions of Section 10(6)(viia). The term 'technician' for purpose of employment commencing on or after 1st April, 1971 (i) *excludes* from its scope persons having specialised knowledge and experience in industrial or business management techniques and *distribution* of electricity or any other form of power or in poultry farming and (ii) *includes* persons with specialised knowledge and experience in agriculture, animal husbandry and dairy farming [but not poultry farming] deep sea fishing and ship building. Experts in constructional or manufacturing operations, or in generation of electricity or any other form of power fall within the term 'technicians'. As a result of this new definition in respect of employments commencing

on or after 1-4-1971, the salary of persons excluded from the definition of 'technicians' will not be exempt and the salary of persons falling within the new definition will be exempt subject to the following conditions:

(a) The technician should not be a citizen of India.

(b) He should render services as a technician in the employment of the Govern- [illegible] authority or of any corporation set up under any special [illegible] body established in India for carrying on [illegible] is approved for this purpose by the prescribed autho- [illegible] carried on in India.

(c) He [illegible] have been resident in India [within the meaning of Section 6] [illegible] years immediately preceding the financial years of [illegible]

[illegible] been empowered to relax this condition with retro[illegible] 1972. Accordingly the Central Government may if it con[illegible] in public interest so to do waive this condition in th[illegible] is employed in India for the designing, erecting or commissioning [illegible] plant or supervising the activities concerned with such designing [illegible] commissioning.

(d) The [illegible] of his services in India should be approved by the Central Government, the application for such approval having been made to the Government before the date of commencement of his service or within six months from that date.

The Central Government is also empowered to notify any additional fields for this purpose so that a foreign technician having the requisite experience, specialised knowledge and skill [illegible] become entitled to claim exemption from tax. It has been clarified that while notifying the additional fields the Central Government should have due regard to the availability of the technicians in the different fields in India, the needs of the [illegible] and other relevant considerations.

The exemption from tax available to a technician is only in respect of his income by way of remuneration for such services in India due to or received by him which is chargeable to tax under the head 'Salaries' but not other income. The amount of exemption shall be the remuneration actually received or Rs. 4,000 per month, whichever is less and exemption will apply only to the sum due to or received by him during the 24 months commencing from the date of his arrival in India subject to the ceiling stated above. If the amount due to or received by him during 24 months commencing from the date of his arrival in India exceeds the limits aforesaid, the tax on the excess will be payable by the employer. If the amount due to or received by the employee exceeds the maximum stated above and tax on the excess is paid by the employer to the Government, the tax so paid by the employer will also be exempt despite Section 200 of the Companies Act.

With regard to the exemption of salary for services after the 24 months approval must be obtained before 1st October of the relevant assessment year for

remaining in employment in India after 24 months and if tax thereon is paid by the employer to the Government such tax will be exempt for a further period of 24 months only. Consequently, if the technician continues to stay in India even after the expiry of forty eight months from the date of his arrival in India there would be no exemption from tax on his remuneration and if the tax on such remuneration is paid by the employer, the tax so paid will also be taxed as a perquisite.

(viii) Salary of Non-residents on Board a Foreign Ship : Income chargeable under the head 'salaries' received by or due to individuals who are non-residents in India for services rendered in connection with their employment or board a foreign ship should be exempt from their total income provided that in each year the stay of the employee in India does not exceed 90 days.

(ix) Salary Income of a Foreign Teacher : Non-resident individuals who have also not been resident in India during the four financial years immediately preceding the financial year of their arrival in India would be exempt from tax on their income from salaries in respect of services rendered by them in India in the capacity of professor or teacher in a university or other educational institution in India. The exemption would be available only if their contracts of service had been approved by the Central Government prior to or within one year from the date of commencement of their services in India, but before the 1st day of October of the relevant assessment year. The period of exemption would be the first 36 months from the date of the commencement of their arrival in India. However, if the foreign teacher continues to stay in India and works in any such institution in the same capacity with approval of the Central Government, then his remuneration for a period of 24 months after the expiry of the first 36 months aforesaid would be tax free in his hands. But the tax on the (tax free) income of this period of 24 months shall have to be paid to the Central Government by the university or the educational institution in which the foreign teacher is employed. In cases where the service of the teacher commenced on or before 1-4-1964, the approval of the Central Government should have been obtained before 1-1-1964 so as to claim this exemption

(x) Income from Research Work : Any income derived by individuals who are not citizens of India for undertaking any research work in India during the period of 24 months from the date of the individual's arrival in India is excluded from total income if –

(a) the research work is undertaken in connection with a research scheme approved by the Central Government in this behalf on or before Ist October of the relevant assessment year; and

(b) such income is payable to the individual directly or indirectly by the Government of the foreign State or any institution or association or other body established outside India.

(xi) Remuneration of Employees of Foreign Governments and Companies : According to Clause (xi) of sub-section (6) of Section 10 of the Income-tax Act, with effect from Ist April, 1976 any remuneration received by an individual being a citizen of any country outside India would be wholly exempt from tax if the remuneration was received in his capacity as an employee of the Government of foreign State during his stay in India in connection with his training in any establishment or office of, or in any industrial or business undertaking owned by (i) the Government; (ii) any company in which the entire paid-up share capital is held by the Central Government

or any State Government/s or partly by the Central Government and partly by any one or more of the State Government/s; (iii) any company which is a subsidiary of any company referred to in item (ii) above; (iv) any statutory corporation which is established by or under a Central, State or Provincial Act; or (v) any society which is registerd under the Societies Registration Act, 1860 or under any other corresponding law for the time being in force and which is wholly financed by the Central Government or any State Government or partly by the Central Government and partly by any one or more of the State Government/s.

Exemption from tax in respect of the remuneration in cases covered by this clause would be applicable to all individuals who are not citizens of India for their services rendered to any of the above five organisations in India without any monetary or other limits.

The Finance Act 1983 has inserted a new clause (6A) in Section 10 with effect from the assessment year 1984-85. The new clause provides that the amount of tax paid by Government or an Indian concern on behalf of a foreign company in respect of royalty or fees for technical services paid under the agreements approved by the Central Government on or after 1st April 1976 will not be included in computing the total income of the foreign company

9 7 Allowances Payable Outside India : Allowances or perquisites paid or allowed as such outside India are exempt from total income provided that—

(a) the recipient is a citizen of India;

(b) the payment is made by the Central Government;

(c) the recipient is an employee of the Government; and

(d) the payment is for services rendered outside India.

For allowing this exemption the residential status of the recipient or the value of the benefits would be immaterial.

9 8 Co-operative Technical Assistance Programme : Individuals who are assigned duties in India in connection with any co-operative technical assistance programme and project would be exempt from tax on their receipts by way of—

(a) remuneration received directly or indirectly from the Government of a foreign State for rendering service; and

(b) any other income accruing or arising outside India (but is not deemed to accrue or arise in India) in respect of which income-tax or other social security tax has been paid to the Government of that foreign state.

This exemption, however, is subject to the following conditions :

(i) The co-operative technical assistance programmes and projects, in connection with which the individual gets income, should be in accordance with an agreement entered into by the Central Government and the Government of a foreign state.

(ii) Terms of the agreement should provide for this exemption.

(iii) The income should be payable to the assessee on account of his services, in that foreign country in connection with the programmes or projects.

(iv) The income should not be deemed to accrue or arise in India under Section 9.

(v) The income in respect of which this exemption is granted should be payable by the foreign Government and should be subject to income or social security tax in that country.

The exemption would be available irrespective of the fact whether the individual is a resident or citizen of India or not and whether the amount in question has been actually received by him or not this exemption applies equally to the income of any member of the family of any such individual referred to above provided that the income (i) actually accrues or arises outside India ; (ii) cannot be deemed to accrue or arise in India ; and (iii) in respect of which income or social security tax has been paid to the Government of the foreign State. Even in this case the nature of the receipt of its source in the foreign country are immaterial for consideration.

9.9 **Gratuity** : The amount of —

(i) any death-cum-retirement gratuity received under the Revised Pension Rules of the Central Government or as the case may be, the Central Civil Services (Pension) Rules, 1972 or under any similar scheme applicable to the members of the civil services of the Union the holder of posts connected with defence or of civil posts under the Union [other than those covered by the Central Services (Pension) Rules, 1972] or to the members of the all-India services or to the members of the Civil Services of a State or holders of civil posts under a State or to the employees of a local authority ; or

(ii) retiring gratuity received after 1-6-1953 under the Pension Code by members of the Defence Services ; or

(iii) any gratuity received under the Payment of Gratuity Act, 1972 : and

(iv) any other retiring gratuity received from the employer ;

would be exempt from being included in the total income of the employees.

No ceiling limits in regard to the death-cum-retirement gratuity received by civilian Government servants and retiring gratuity received by members of the Defence services have been prescribed in the law because such gratuities are subject to the ceiling limits under the relevant rules which are similar to those specifically laid down in the Act.

The exemption in respect of gratuity received by employees of statutory corporations and employees in the private sector will be available *only if* such gratuities received on retirement, incapacitation or death of the employee or on termination of the employment. Thus, any gratuity received otherwise than on death, retirement, termination of employment and incorporation would not qualify for exemption even if it is within the limits specified in the Section. In cases where the gratuity becomes due for payment otherwise than as a result of the employee's retirement or incapacitation, the tax exemption would be available to the extent the gratuity is received by the widow, children or dependents of the employee.

The full amounts of gratuities referred to in cases (i) and (ii) above are exempt from total income without any limit.

With effect from 1-4-1975 any gratuity received under the Payment of

Gratuity Act, 1972 would be wholly exempt from income-tax to the extent it does not exceed an amount calculated in accordance with the provisions of sub-sections (2) and (3) of Section 4 of that Act.

In all those cases of receipt of gratuity covered by (iv) above the exemption would be restricted to the *least* of the following four amounts.

(i) The amount actually received.

(ii) One-half month's salary for each year of completed service calculated on the basis of the average salary for the three years immediately preceding the year in which the gratuity is paid

(iii) Twenty months' salary as calculated in (ii) above.

(iv) Rs. 36,000

In cases where gratuity is received by an employee from more than one employer in the same previous year, the aggregate amount exempt from income-tax under Section 10 (10) shall not exceed Rs. 30,000 Where any gratuity was or gratuities were received in any one or more earlier previous year/s also and the whole or any part thereon was exempt from income-tax under Section 10 (10) for the relevant assessment year the amount of exempt gratuity shall be first calculated as aforesaid and shall then be reduced by the aggregate amount of exemption allowed to the assessee in the earlier year/s. For purposes of tax exemption the meaning of the term 'salary' should be taken to be the same as given in Rule 2 (h) of Part A of the Fourth Schedule to the Income-tax Act, 1961.

It may be noted that the monetary limit of Rs. 36,000/- is fixed by the Finance Act 1983, with retrospective effect from the assessment year 1982-83 onwards. Prior to this, the limit was Rs. 30,000. The Central Government is also empowered to increase this limit by issue of appropriate notification keeping in view the maximum amount of gratuity which may be exempt in the case of government servants.

In cases where the gratuity received exceeds the amount exempt, the excess over the exempted amount shall be taxable as income of the assessee from salaries. This exemption would not be denied merely on the ground that the rules of the employer provide for the calculation of the amount of gratuity on any other method, including dearness allowance. For claiming this exemption the residential status and citizenship of the individual are immaterial.

9 10 Payment in Commutation of Pension: Moneys received in commutation of Pension are wholly exempt from tax under Section 10 (10A) (i) in all cases where the receipt of this amount is under the Civil Pension (Commutation) Rules of the Central Government or under any similar scheme applicable to the members of the civil services of the Union or holders of posts connected with defence or of civil posts under the Union (such members or holders being persons not governed by the Rules) or to the members of the All India Services or to members of the Defence Services or to the members of the civil services of a State or to the employees of a local authority or a corporation established by a Central, State or Provincial Act.

But in the case of amounts received in commutaion of pension from an em-

ployer other than the Central or State Government, local authority, or a statutory corporation, the amount of exemption shall be subject to the following limits :

(a) In the case of amounts received in commutation of pension before 19th August, 1965 the entire amount received is exempt.

(b) In the case of amounts received in commutation of pension on or after 19th August, 1965.

(i) where the employee also receives any gratuity the maximum amount of exemption is restricted to the commuted value of 1/3rd of the pension which he is normally entitled to receive.

(ii) in any other case, the maximum amount of exemption is one-half of the pension which he is normally entitled to receive.

In all these cases the commuted value must be determined having due regard to the age of the recipient the state of his health, the rates of interest and the officially recognised tables of mortality. Here again, the exemption is available regardless of the residential status or citizenship of the recipient.

9 : 10 Amendments made by Finance Act, 1982.

The Finance Act 1982 has inserted a new Clause (10AA) in Section 10 with retrospective effect from 1st April, 1978 with a view to providing exemption in respect of amount received by way of encashment of unutilised earned leave by employees at the time of retirement. Under this provision cash equivalent of leave salary payable to an employee of the Central Government or the State Government in respect of the earned leave to his credit at the time of his retirement on superannuation or otherwise will be totally excluded from the computation of his total income.

In the case of employees other than those of the Central Government or the State Government the exemption will be determined with reference to the leave to his credit at the time of retirement subject to a maximum of six months leave. The exemption will be limited to the amount payable for such unutilised leave on the basis of the average salary of the employee or Rs. 30,000 whichever is less. In relation to employees who retired before January 1, 1982, the maximum amount qualifying for exemption would be Rs. 25,500. For this purpose the entitlement to leave shall not exceed 30 days for every year of service and "average salary" shall be determined on the basis of salary drawn for 10 immediately preceding months. The Government is also empowered to raise the aforesaid monetary ceiling in the case of non-government employees by notification in the official gazette keeping in view the maximum amount which will qualify for exemption in the case of Government employees.

Where the cash equivalent of unutilised earned leave is received by an employee from two or more employers in the same year, the maximum amount exempt from tax will not exceed Rs. 30,000. In cases where an employee who has received any cash equivalent of unutilised earned leave in any earlier year from his former employer or employers receives cash equivalent of unutilised earned leave from his Present employer in a later year the ceiling limit specified above will be reduced by

the amount of cash equivalent of unutilised earned leave which has been exempted in an earlier year or years.

9.11 Compensation received by Employees : Under clause (10B) of Section 10 any compensation received by a workman under the Industrial Disputes Act, 1947, or under any other Act or Rules, Orders or Notification issued under the Act or under any standing orders or under any award, contract of service or otherwise would be wholly excludible from the total income and thus exempt from income tax if such compensation is received by the employee at the time of his retirement. For this purpose any compensation received by a workman at the time of the closing down of the undertaking in which he is employed must be treated as an item of compensation received by him at the time of his retrenchment. Likewise any compensation received by a workman at the time of the transfar (whether by virtue of an agreement or as a result of the operation of any provision of law for the time being in force) of the ownership or management of the undertaking in which he is employed from the employer in relation to that undertaking to a new employer must also be deemed to be a compensation received by the employee at the time of his retrenchment if any of the following conditions are satisfied.

(i) the service of the workman is interrupted by virtue of such transfer; or

(ii) the terms and conditions of the service of the employee after such transfer are in any way less favourable to the workman than those applicable to him immediately prior to the transfer; or

(iii) the new employer is, under the terms of such transfer or otherwise, legally not liable to pay to the workman, in the event of his retrenchment compensation on the basis that his service has been continuous and has not been interrupted by the transfer.

The amount of compensation which is exempt from tax in the hands of the employee should not, in any case, exceed the *lowest* of the following three amounts :—

(i) the amount actually received as compensation at the time of retrenchment.

(ii) the amount calculated in accordance with the provisions of Section 25F (b of the Industrial Disputes Act, 1947, or

(iii) Rs. 20,000.

For the purpose of granting this exemption the meaning of the words 'emplc yer' and, 'workmen' must be taken to be the same as contained in the Industrial Dis putes Act, 1957.

9.12 Payments from Provident Funds : Any payment received by an assessee fror provident fund to which the Provident Fund Act applies or from the Public Prov dent Fund set up by the Central Government under the Public Provident Fur (Scheme) Act, 1968 would be entirely excluded from the total income. Similar amount representing the accumulated balance due and becoming payable to an er ployee participating in a Recognised Provident Fund would be exempt from t subject to the conditions specified in Rule 8 of Part A of the Fourth Schedule to t Act. The conditions are that:

(a) the employee should have rendered continuous service with the employer from whom the amount is received for a period of at least five years; or

(b) though the employer had not rendered such continuous service for five years or more, his service with the employer had been terminated on account of the employee's ill-health, contraction or discontinuance of the employer's business or any other causes beyond the control of the employee.

9.13 **Payments out of an Approved Superannuation Fund** : Any payment received by an employee from an approved superannuation fund shall be entirely excluded from his total income if the payment is made --

(a) on the death of a beneficiary;

(b) to an employee in lieu of or to in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or

(c) by way of refund of contributions on the death of a beneficiary; or

(d) by way of refund of contributions to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement.

In the case of (d) above the amount of exemption will be to the extent payment so made does not exceed the contributions made prior to 1-4-1962 and the interest theron. An annuity or pension paid to the widow of a deceased employee would also fall under this exemption.

9.14 **House Rent Allowance** : Any special allowance specially granted by way of reimbursement to an employee by his employer to meet the expenditure incurred on payment of rent for the residential accommodation occupied by the assessee is excludible from the total income of the employee. The exemption, however, is subject to the limits prescribed by the Central Board of Direct Taxes having due regard to the area or place in which the residential accommodation is situated and other relevant considerations. Under Rule 2A of the Income-tax Rules, 1962 the Central Board of Direct Taxes has prescribed the *least of the* following four amounts as being excludible from total income, *viz*,:

(a) the amount of house rent allowance actually received by the assessee in respect of the relevant period;

(b) the amount by which the expenditure actually incurred by the assessee towards payment of rent in respect of the residential accommodation occupied by him exceeds one-tenth of his salary for the relevant period;

(c) an amount equal to—

(i) 1/5th of the salary of the assessee for the relevant period when the residential accommodation is situated at Ahmedabad, Bangalore, Bombay, Calcutta, Delhi, Hyderabad, Kanpur, Madras or Poona; with effect from 1st

April, 1975 residential accommodation if situated at Agra, Amritsar, Allahabad, Cochin, Coimbatore, Indore, Jabalpur, Jaipur, Luknow, Madurai, Nagpur, Patna, Sholapur, Srinagar, Surat, Trivandrum, Baroda and Varanasi is also covered similarly.

(ii) 1/10th of the salary for the relevant period where the residential accommodation is situated at any other place; or

(c) a sum calculated at the rate of Rs. 400 p.m. in respect of the relevant period.

[illegible] interpreted as to include dearness allowance [illegible] excluding all other allowances [illegible] relevant period means the period during which [illegible] the assessee during the previous year.

[illegible] allowance or benefit (not being in the nature of [illegible] allowance [illegible] perquisite) specifically granted to [illegible] to meet the expenses wholly necessarily [illegible] of his duties of an officer or employment of profit [illegible] included in the total income. Special travelling allowances [illegible] allowances or reimbursement of other expenses incurred in connection with the employment are covered by this exemption. This exemption, however, is subject to the following four conditions being complied with :

(i) The special allowance or benefit should be granted specifically to meet such expenses.

(ii) The allowance or benefit should not be in the nature of an entertainment allowance or other perquisite chargeable to tax whether wholly or in part.

(iii) The expenses should have been wholly, necessarily and exclusively incurred by the employee in the performance of his duties of an office or an employment of profit.

(iv) The receipt of such allowance should be from the employer.

In all cases the amount of exemption is limited to the extent to which such expenses were actually incurred by the assessee. The exemption in addition to being supplementary to deduction allowed from salary under Section 16 (1) also covers the case where the emoluments of the office referred to may be taxable as income from any other source. However, this exemption would not cover a case (i) where a firm of commission agents who charge their customers a particular sum per bag in addition to the usual commission towards service charges or (ii) where fees for services which are paid for collecting land revenue and which have no reference to the expenses incurred into the collection, are claimed as exempt income.

The explanation to Section 10(14) specifically provides that any allowance granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides shall not be regarded as a special allowance granted to the

employee to meet the expenses which are wholly, necessarily and exclusively incurred by him in the performance of his duties as an employee. Thus allowance like city compensatory allowance will not be eligible for exemption under this provision.

9.16 Income from annuities or interest in certain cases : The income from the deposits and securities enumerated below issued by the Central Government or under its authority are exempt from being included in the total income of all assessees :

(i) monthly payment on 15 year Annuity Certificates or similar certificates declared to be tax free;

(ii) annual payments on the National Defence Gold Bonds, 1980;

(iii) Interest payable on such Capital investment Bonds as may be notified by the Central Government in this behalf—It may be noted that Finance Act, 1982, inserted this provision w.e.f. 1.4.1983 (for the assessment year 1983-84 and subsequent years). The Finance Act, 1983 has clarified that the above exemption is available to individuals and Hindu undivided families only.

(iv) interest on—

(a) Treasury Savings Deposit Certificate

(b) Post Office Cash Certificates,

(c) National Plan Certificates,

(d) Twelve Year National Savings Certificates,

(e) Any other certificates issued by the Central Government and specified to be exempt under this clause.

(f) Post Office Savings Banks deposits and

(g) Fixed Deposits under any Scheme framed by the Central Government *e.g.*, 5-year fixed deposits under the Government Savings Certificates Rules, 1968.

(h) Bonus in respect of deposits under the Post Office Savings Bank Cumulative Time Deposits Rules, 1959

Futher, in all above cases the amount of exemption is limited to the interest or other income from these certificates or deposits which do not exceed the maximum amount permitted to be invested therein;

In cases where the assessee derives interest on deposits in public account of the nature specified in item (3) in the table below Rule 3 of the Post Office Saving Bank Rules, 1965 and the amount so derived exceeds Rs 2,250, the benefit of total exemption from Income tax would be limited to the interest upto Rs. 2,250 thus making the excess of such interest not qualifying for exemption under Section 10 (15). However, the excess may qualify for deduction from gross total income under Section 80L.

(v) interest on fixed deposits under any scheme framed by the Central Government and notified by it in this behalf in the Official Gazette, to the extent to which the amounts of such deposits do not exceed, in each case, the maximum amount which is permitted to be deposited therein;

(vi) interest on securities held by the Issue Department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1964;

(vii) interest payable—

(a) by the Government or a local authority on moneys borrowed by it from *or debts owed by it to sources* outside India;

(b) by an industrial undertaking in India on moneys borrowed by it under an agreement with an approved financial institution:

(c) by an industrial undertaking in India on moneys borrowed or debt incurred by it in a foreign country for the purchase outside India of raw materials *or components* or capital equipment provided that the loan or the debt is approved by the Central Government. For the purposes of this item "purchase of capital plant and machinery" includes the purchase of such capital plant and machinery under a hire purchase agreement or a lease agreement with an option to purchase such plant and machinery

(The extent of exemption is an amount not exceeding the amount of interest calculated at the rate approved by the Central Government, having due regard to the terms of the loan or debt and its repayment.)

(d) by the Industrial Finance Corporation of India, or the Industrial Development Bank of India or the Industrial Credit and Investment Corporation of India as the Export-Import Bank of India on any money borrowed by it from sources outside India, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government, in this behalf, having due regard to the terms of the loan and its repayment;

(e) by any other financial institution established in India or a Banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in Section 51 of that Act) on any moneys borrowed by it from sources outside India under a loan agreement approved by the Central Government where the moneys are borrowed either for the purpose of advancing loans to industrial undertakings in India for purchase outside India of raw materials or capital plant and machinery or for the purpose of importing any goods which the Central Government may consider necessary to import in the public interest to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf having regard to the terms of the loan and its repayment; and

(f) by any industrial undertaking in India on any moneys borrowed by it in foreign currency from sources outside India under a loan agreement approved by the Central Government having due regard to the need for industrial development in India, to the extent to which such interest does not exceed the amount of interest calculated at the rate

approved by the Central Government in this behalf having regard to the terms of the loan and its repayment.

(g) by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, on any moneys borrowed by it in foreign currency from sources outside India under a loan agreement approved by the Central Government. This exemption will be available to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government. The exemption will apply if the company has been approved by the Central Government for the purpose of Section 36 (1) (viii) of the Income Tax Act.

Note : All the additions made in italics are applicable with effect from 1983-84 assessment year.

9.17 **Scholarships** granted to meet the cost of education would be exempt from tax in the hands of the recipient in respect of the amount or source of the scholarship.

9.18 **Daily Allowances** (but not salary) of Members of the Parliament or of any State Legislature or of any committee thereof or any allowance received by a member of either House of Parliament under the Member of Parliament (Additional Facilities) Rules, 1975 would be also excludible from their total income.

9.19 **Gallantry and other Awards and Rewards** : Payment by the Central or any State Government in pursuance of gallantry awards shall be excluded from total income irrespective of the fact whether the payment is made in cash or kind or whether the recipient is a resident of India or not.

Similarly under Section 10 (17A) any payments made, whether in cash or in kind, in pursuance of awards for literary, scientific and artistic work or attainment of or for proficiency in sports and games instituted by the Central Government or by any State Government or approved by the Central Government in this behalf is wholly exempt from income tax. For this purpose, the approval granted by the Central Government shall have effect only for the assessment year/s (including any assessment year commencing before the date on which the approval is granted) which is/are specified in the order granting the approval.

Awards for literary, scientific or artistic work or attainment or for service for alleviating the distress of the poor, the weak and the ailing (*e.g.*, Nobel Prize) are also wholly exempt from tax from 1-4-1980.

Likewise any payment made whether in cash or in kind, as a reward by the Central Government or any State Government for such purposes as may be approved by the Central Government in the public interest would also be wholly exempt from tax under Section 10 (17B).

9.20 **Privy Purses** : Amount received by the ex-Ruler of an Indian State by way of ex-gratia payments from the Central Government consequent on the abolition of privy purses were exempt from tax in full.

9.21 Income of Local Authority : A local authority, though it is a taxable unit, is exempt from tax on its entire income from whatever source derived, *except* in cases (i) where the income is derived from a trade or business carried on by it, *and* (ii) such income does not arise from the supply of a commodity or service within its own jurisdictional area, income derived by a local authority from the supply of water or electricity outside its own jurisdictional area will also be exempt from income-tax. For all tax purposes, except for this exemption, a local authority stands in the same position as an individual or a company.

9.22 Income of Housing Boards : The entire income (irrespective of its source) of an authority including a board constituted in India by or under any law enacted for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities. towns and villages or for both would be excludible from the total income.

9.23 Income of Scientific Research Associations : The income of a scientific research association, regardless of its source, which for the time being is approved by the Central Government or the Central Board of Direct Taxes for purposes of allowing deduction under Section (35) (i) (ii), shall be exempt from tax. The exemption, however, would apply only to that part of the income which is applied solely for purpose of promoting or carrying out scientific research. This exemption presupposes that the scientific research association, has as its main object, the undertaking of scientific research.

The Finance Act, 1983 has added a proviso to Section 10 (21). Accordingly, the requirement for investment of funds according to the pattern prescribed in Section 11 (5) will apply to a Scientific Research Association which is approved under Section 35 (1) (ii). Such an association will have to invest the contributions received by it on or after 1.3.1983 as per the provisions of Section 11 (5). As regards the investments made before 1.3.1983, the association will have to regularise the same and bring them in line with the new pattern of investment on or before 30.11.1983. It is also provided that such an association cannot hold shares in any private sector company on or after 1.12.1983. If the association does not comply with the above requirements, it cannot claim exemption in respect of its income under Section 10(21).

9.24 Income of Educational Bodies : The entire income of a University, college, or other educational institution established in India and existing solely for educational purposes and not for purposes of profit is exempt from income-tax. For purposes of this exemption, it is immaterial to consider the level or standard at which the institution imparts education, the nature and composition of its management, the fields of education covered *etc*.

9.25 Income of Hospitals : Any income of a hospital or other institution run for (i) the reception and treatment of persons suffering from illness or other mental defectiveness or (ii) the reception and treatment of persons during convalescence or of persons requiring medical treatment attention or rehabilitation would be exempt from tax provided that the hospital or other institution exists solely for philanthropic purposes of profit.

9.26 Income of Sports Associations : The income of sports bodies established in India is excludible from total income if all the following conditions are fulfilled :

(a) Its object is the control, supervision regulation or encouragement in India of the games of cricket, hockey, football, tennis or other games and sports specified by the Central Government.

(b) The income is applied or accumulated for being applied solely for the purposes of the objects for which it is established.

(c) No part of the income is distributed in any manner to its members except by way of grants to any association or institution affiliated to it.

(d) The association or body is, for the time being, approved by the Central Government for the purposes of this exemption by a general or special order.

9.27 Income of Professional Association : Any professional association or body (like the Bar Council of India) is exempt from tax on its income provided that the following conditions are satisfied.

(a) The association or body is established in India.

(b) It has as its object, the control, supervision, regulation of encouragement of the profession of law, medicine, accountancy, engineering, architecture or any other profession specified by the Central Government.

(c) It is for the time being approved by the Central Government for purposes of this exemption.

The exemption would be applicable only in respect of the income of the association or body which is applied or is accumulated for application, solely, for the fulfilment of the objects for which the association was established. The exemption however, does not apply to the income of the association which represents—

(i) income from interest on securities ;

(ii) income from house property;

(iii) income received for rendering any specific services to its members;

(iv) income by way of interest or dividends derived from its investment.

9.28 Income of certain funds set up by the armed forces :

Section 10 (23A) provides for total exemption in respect of the income of the Regimental Funds or Non-Public Funds established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependants.

9.29 Income of Trusts and Institutions Established for Promoting Khadi and Village Industries : According to Section 10 (23B) any income of an institution constituted as a public charitable trust or a society established under the Societies Registration Act, 1860 or under any law corresponding to that Act in any part of India and existing solely for the development of khadi or village industries or both, and not for purposes of profits, is exempt from tax to the extent such income is attributable to the business of production, sale or marketing of khadi or products of village industries. The exemption is, however, subject to the following conditions:

(i) *The institution applies its income or accumulates it for application, solely for the development of khadi or village industries or both.*

(ii) *The institution is, for the time being, approved by the Khadi and Village Industries Commission for the purpose of this exemption.*

For this purpose the expression "*Khadi* and *Village Industries*" have the meaning respectively assigned to them under the Khadi and Village Industries Commission Act, 1956.

Under the provision of sub-section (23BB) any income of an authority, whether known as the Khadi and Village Industries Board or by any other name, established in a State by or under a State or Provincial Act for the development of khadi and village industries in the State would be wholly excludible in computing the total income of the authority. For this purpose the nature of the income, the head of income as well as the amount of income would be immaterial.

9.30 Income of Charitable Trusts and/or Institutions : Sub-section (23C) in Section 10, grants tax exemption to the following charitable funds and institutions. The benefit of exemption under the five clauses of sub-section (23C) would now be available to the income received by any person on behalf of –

(i) the Prime Minister's National Relief Fund; or

(ii) the Prime Minister's Fund (Promotion of Folk Art) ; or

(iii) the Prime Minister's Aid to Students Fund ; or

(iv) any other fund or institution established for charitable purposes which may be notified by the Central Government in the Official Gazette having due regard to the objects of the fund or institution and its importance throughout India and throughtout any state/s ; or

(v) any trust (including any other legal obligation) or institution being a trust or institution established wholly for public religious purposes or wholly for public religious and charitable purposes which may be notified by the Central Government in the Official Gazette having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that income accruing to the trust is properly applied for the charitable purposes of the trust or institution.

Any notification issued by the Central Government in respect of items (iv) and (v) above shall be effective for such assessment year/s commencing even before the date on which the notification is issued. The relevant assessment years, for which the exemption will be available, must be specified in the Gazette Notification.

9.31 Tax Exemption to Statutory Bodies or Authorities for the Administration of Public Religious or Charitable Trusts or Endowments : Sub section (23BBA) of Sec. 10 grants total exemption from income-tax to any income of any body or authority (whether or not a body corporate or a corporation sole) established, constituted or appointed by or under any Central, State or Provincial Act which provides for the administration of any one or more of the following : Public religious or charitable

trusts or endowments (including maths, temples, gurdwaras, wakfs, churches, synagogues or other places of public religious worship or societies for religious or charitable purposes registered as such under the Societies Registration Act, 1860 or any other law for the time being in force. However, it has been clarified by the proviso to the new Section 10(23BBA) that the income of any trust, endowment or society should not be regarded as qualifying for exemption. In other words, the object of the new provision is to exempt from income-tax the income arising to any body or authority established, constituted or appointed under any enactment for the administration of such public religious or charitable trusts or endowments or societies for religious or charitable purposes. For instance, the provisions of Sections 8A and 9 of the Wakf Act, 1954 authorise the Central Government to constitute the Board of Wakf for each State. The income derived by such a Board as well as the Central Wakf Council would be wholly exempted from tax under the new provision. The income of the charitable or religious trust or endowment society which does not fall within the scope of this provision may, however, qualify for exemption from income-tax under Sections 11 to 13 of the Income-tax Act, subject, however, to the fulfilment of the conditions specified thereunder.

9.32 **Income of Trade Unions** : A registered trade union falling within the purview of the Indian Trade Unions, Act, 1926 is exempt from tax on its income chargeable to tax under the heads 'Interest on securities', 'Income from house property' and 'Income from other sources' provided that the union is established primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen.

9.33 **Income of Provident Funds, Superannuation Funds and Gratuity Funds** : The income arising to a recognised provident fund, and approved superannuation funds and an approved gratuity fund is exempt from tax and the trustees of these funds would not be liable to tax thereon (tax exemption to approved gratuity funds has been introduced with effect from 1-4-1973). This exemption also applies to (i) the interest on securities which are held by or are the property of a statutory provident fund governed by the Provident Funds Act, 1925 and (ii) the capital gains, if any, arising to it from the sale, exchange or transfer of such securities.

9.34 **Income of a Member of a Scheduled Tribe** : A member of a Scheduled Tribe as defined in Article 366 (25) of the Constitution, residing in (i) any area specified in Parts I and II of the Table appended to Paragraph 20 of the Sixth Schedule to constitution or (ii) in the State of Nagaland, Manipur, and Tripura or in the Union Territories of Arunachal Pradesh and Mizoram or in the areas covered by Notification No. TAD/R/335/50/109 dated 23-2-1951 issued by the Governor of Assam under the proviso to Paragraph 22 (8) as it stood immediately before the commencement of the North Eastern Area (Reorganisation) Act, 1971 shall be exempt from tax on his income arising or accruing :—

(a) from any source in the areas, States or Union Territories aforementioned; or

(b) by way of dividend, interest on securities.

This exemption is available to all assessees including to those who are in the service of the Central or State Government.

9.35. **Income of a Resident of Ladakh :** All income arising to a resident (including a company) in the district of Ladakh from any source in that district or outside India is exempt from tax if the person was resident in the district of Ladakh in the previous year relevant to the assessment year 1962-63. This exemption is available upto and inclusive of the assessment year 1982-83.

9.36 **Income of Statutory Corporations for the Welfare of Scheduled Castes and Tribes :** Under Section 10 (26B) any income of a corporation established by a Central, State or Provincial Act or of any other body, institution or association wholly financed by the government is exempt from tax in cases where such corporation, association or institution has been established or formed for promoting the interests of either the Scheduled Castes or the Scheduled Tribes or both.

9.37 **Tax Credit Certificates :** Amounts adjusted or paid in respect of tax credit certificates granted to the assessee under the Tax Credit Certificate Schemes and Rules covered by Chapter XXII-B of the Act are excludible from the total income of any person.

9.38 **Income of Marketing Societies :** Any authority, including a society constituted under any law for the time being in force, for the marketing of commodities is exempt from tax in respect of any income derived by it from the letting of godowns or warehouses for the storage, processing or from facilitating the marketing of commodities.

9.39 **Subsidies Received from the Tea Board :** Any subsidy received by any assessee engaged in the business of growing and manufacturing tea in India through or from the Tea Board under any scheme for replantation or replacement of tea bushes which may be notified in this behalf by the Central Government in the Official Gazette, will be wholly exempt from tax. The exemption will be available only if the assessee furnishes to the Income-tax Officer, along with his return of income for the relevant assessment year [or within the extended time allowed by the I.T.O. for the purpose], a certificate from the Tea Board as to the amount of the subsidy received by him during the accounting year.

10. TAX HOLIDAY FOR NEW INDUSTRIAL UNITS IN FREE TRADE ZONES

The Finance Act, 1981 has introduced in the Income-tax Act, a new provision, Section 10A with a view to providing for total tax exemption in respect of newly established industrial undertakings in free trade zones. This new provision is effective from 1st April, 1981 (Assessment Year 1981-82 and onwards). The objective behind this provision is to encourage establishment of export oriented industries in free trade zones. At present there are two free trade zones, *viz.*, Kandla Free Trade Zone and Santa Cruz Electronics Export Processing Zone. This concession will also apply in relation to any other free trade zone that may be set up in future and notified by the Central Government for this purpose.

Under this provision, any profits and gains derived by an assessee from an industrial undertaking set up in these zones to which the Section applies will be exempt for a period of five assessment years commencing from the initial assessment year—the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things—and the four succeeding assessment years. They are referred to as the 'relevant assessment years'. In order to enjoy this concession, the industrial undertaking should satisfy certain conditions, *viz.* that it begins to manufacture or produce articles of things during the previous year relevant to the assessment year 1981-82 or any subsequent assessment year in any free trade zone. It should not have been formed by the splitting up or by reconstruction of a business already in existence and it should not have been formed by the transfer to a new business of machinery or plant previously used in any business. For the purposes of this Section, reconditioned imported machinery and plant will be regarded as new. Where the total value of the machinery or plant transferred to the new business does not exceed 20% of the total value of the machinery or plant used in that business, the last mentioned condition will be deemed to have been complied with. Sub-section (4) of Section 10A provides that notwithstanding anything contained in any other provision of the Act, in computing the total income of the assessee of the previous year relevant to the assessment year immediately succeeding the last of the relevant assessment years or of the previous year relevant to any subsequent assessment year, the unabsorbed depreciation allowance, the unabsorbed investment allowance, the unabsorbed development rebate, the unabsorbed capital expenditure on scientific research, the unabsorbed capital expenditure for family planning relating to the relevant assessment years will not be taken into consideration. Similarly, unabsorbed business losses or losses under the head 'Capital Gains', or the deficieney relating to tax holiday profits relating to the relevant assessment years will not be taken into account. Where the assessee was entitled to a deduction for the relevant assessment years in respect of the profits and gains from newly established industrial undertakings in backward areas or small-scale industrial undertakings in rural areas or the tax holiday, no deduction will be admissible in the assessment years subsequent to the relevant assessment year. Further, in computing the depreciation allowance on any assets in the assessment years following the relevant assessment years, the written down value will be computed as if the assessee had claimed and been allowed the depreciation in respect of the assets in accordance with the provision of the Income-tax Act during each one of the relevant assessment years.

Sub-section (5) of Section 10A provides that where any industrial undertaking situated in a free trade zone has begun to manufacture or produce articles or things during any of the previous years relevant to the assessment years 1977-78 to 1980-81, such assessee may at its option before the expiry of the time allowed for the furnishing of the return of income for the assessment year 1981-82 furnish to the Income-tax Officer, a decalaration in writing that the provisions of this Section namely—Section 10A - may be made applicable to him for the relevant assessment years other than the assessment years commencing before the assessment year 1981-82 and if he does so then the provisions of complete tax holiday specified in this Section will apply for such assessment years and the provisions of new sub-section (4) will also apply to any assessment year following the relevant assessment year.

The provisions of sub-sections (8) and (9) of Section 80I relating tax holiday—transfer of goods for less than market price or arrangement of business in such a way as to produce to the assessee more than ordinary profits—have been made applicable to the industrial undertakings referred to in Section 10A also. Sub-section (7) o Section 10A provides an important option to the assessee *not* to avail of the benefit of complete tax holiday under this Section and to avail of all other benefits like investment allowance, depreciation, carry forward of business losses, tax holiday benefits under Section 80I, 80HHA, as the case may be just like any other assessee starting new industrial undertaking. Such an option could be exercised by the assessee before the expiry of the time allowed for filing the return under Section 139 for the initial assessment year by filing a declaration in writing to the effect that the provisions of this Section may not be made applicable to him for any of the relevant years. In such an event, the assessee will not be entitled to the complete exemption under this provision but would be eligible to claim all other allowance like ny other assessee.

11. Tax Exemptions to Charitable or Religious Trusts and Institutions

A general discussion on 'Trusts' : Before considering the provisions of Sections *11 to 13* which govern the exemption in respect of income from property held for charitable or religious purposes, let us see briefly what exactly the term 'trust' signifies, the types of trusts and the manner of their creation. Though this aspect of the topic does not strictly fall within the purview of our subject, *viz.*, Income-tax, such a general knowledge would be useful in understanding the provisions of the tax laws relating to charitable trusts.

A 'Trust' is an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of another or of another and the owner. The person who reposes or declares the confidence is called the 'author of the trust', the person who accepts the confidence is called the trustee'; the person for whose benefit the confidence is accepted is called the 'beneficiary'; the subject matter of the trust is called 'trust property' or trust money'; the 'beneficial interest' or 'interest' of the beneficiary is his right against the trustees as owner of the trust property and the instrument, if any, by which the trust is declared is called the 'instrument of trust'.

Trusts can be broadly classified into two groups—Public and Private. The distinction between a public and private trust is that whereas in the former the beneficiaries are the general public or a class thereof, in the latter they are specific individuals. While in the former the beneficiaries constitute a body which is incapable of ascertainment, in the latter they are persons who are ascertained or capable of being ascertained. In some cases, private trusts may enure for the benefit of the public. Some religious trusts may also be in the nature of public-cum-private trust.

Private trusts are governed by the Indian Trust Act, 1882. This Act does not apply to the following :—

(1) The rules of Mohammedan law as to wakf ;

(2) The mutual relations of the members of undivided family as determined by any customary or personal law ;

(3) Public or private religious or charitable endowments ; and

(4) Trusts to distribute prizes taken in war among the captors

From the above, it will be clear that public charitable trusts are not governed by the Indian Trusts Act.

Both Private and Public trust may be created *inter vivos* or by will. In the case of public trusts, three certainties are required to create such a trust. They are (1) a declaration of trust which is binding on settlor, (2) setting apart definite property and depriving himself of the ownership, and (3) a statement of subjects for which the property is thereafter to be held. In the case of private trusts also more or less similar requirements exist. A private trust is created when author of the trust indicates with reasonable certainty by any words or act (a) an intention on his part to create thereby a trust, (b) the purpose of the trust, (c) the beneficiary, and (d) the trust property and unless the trust is declared by will, the author of the trust himself transfers the trust property to the trustee.

A formal deed is not necessary to constitute a public trust or a legal obligation binding on the trustees. In the case of private trusts, if the trust property is immovable property a registered deed should be executed unless the trust is created by a will. If the trust is in relation to movable property such registration of deed is not required.

The word 'trust' as used in the context of Sections 11 to 13 of the Income-tax Act includes, in addition to the 'Trust' as explained above, '*any other legal obligation*'. This is made clear in Explanation 1 to Sec. 13. The words any other legal obligation are wide enough to cover Muslim wakfs, Hindu endowments and dedications to deities. It would also cover a case in which the trustees of a settlement are to pay the income to other trustees who in their trun are bound to apply it for purposes which are religious or charitable.

TAX EXEMPTION TO CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS (Sections 11-13)

Subject to the provisions of Sections 60 to 63, the income of a religious or charitable trust or institution, to the extent specified in the Act, is exempt from taxation altogether when certain prescribed conditions are fulfilled. The exemption is not only from the charge to tax. The relevant income does not even form part of the total income of the trust or institution.

Section 11 deals with the exemption of income from property held in trust or other legal obligation for religious or charitable purposes wholly or in part. Section 12 deals with exemption of income derived by such a trust from voluntary contributions. Section 12A prescribes the conditions as to registration of trusts etc. Section 13 enumerates the circumstances under which the exemptions available under Sections 11 and 12 will be denied.

1. **Income from property held for charitable or religious purposes**

The following income shall not be included in the total income of the previous year of the person in receipt of the income.

a. Income derived from property *held under trust wholly* for charitable or religious purposes to the extent such income is applied in India for such purposes.

b. *Income derived from property held under trust in part only for such purposes, to the extent such income is applied in India for such purposes. However the trust in question must have been created before the commencement of I.T. Act. 1961.*

c. *Income derived from property held under trust, created on or after 1.4.1952 for charitable purpose which tends to promote international welfare in which India is interested to the extent to which such income is applied to such purposes outside India.*

d. Income derived from property held under a trust for charitable or religious purposes, *created before* 1.4 52 to the extent to which such income is applied to such purposes outside India.

Thus it can be noted that only such income derived from property held under trust wholly for charitable or religious purposes is exempt. If the property is held *in part only* for such purposes, it is necessary that such a trust must have been created before the commencement of the I.T. Act 1961. In both the cases the exemption is limited to the extent such income is applied in India for such specified purposes.

To get exemption in respect of income applied outside India, the trusts are divided into two types.

(a) If the object of the trust is to promote international welfare in which India is interested, such trust may have been created *on or after* 1.4.1952.

(b) If the trust is for any other charitable purpose it must have been created before 1.4 1952.

Here also the exemption is limited to the extent to which such income is applied outside India for such specified purposes. It is to be noted however that a direction from CBDT by a general or special order from the Central Board of Direct Taxes is necessary before such exemption can be claimed.

Property held under Trust

The exemptions explained in the preceeding paragraphs are available *if and only if* there is a valid trust or there is a legal obligation, under which the income derived from the property held under such trust or legal obligation is to be applied for charitable or religious purposes. If there is no trust nor any legal obligation, the income will not be exempt *even if the whole of such income is applied to charitable or religious purposes. A mere creation of a trust for the income is not sufficient*, there must be a trust of the property out of which the income is derived before one can consider whether there is a possibility of any exemption under Section 11.

Charitable Purposes

Section 2(15) states that 'charitable purpose' includes relief of the poor, education,

medical relief and the advancement of any other object of general public utility. Sec. 10(21) totally exempts the income of an approved scientific research association which is applied solely to the purposes of that association. Section 10(22A) exempts any income of hospitals and other medical institutions not existing for profit. Section 10(22) exempts any income of a university or other educational institution, existing solely for educational purposes and not for purposes of profit. An institution or trust for "the relief of the poor, education, medical relief and the advancement of any other object of general public utility", therefore means for all practical purposes in the context of Sections 11, 12, 12A and 13 a body other than a scientific research association or a hospital or an educational institution covered by clauses (21) (22A) and 22 respectively of Section 10.

The definition of "charitable purpose" includes "any other object of general public utility". The question arises as to what is an object of "general public utility" This expression has not been defined anywhere in the Act.

The Supreme Court in the case of *CIT v Andhra Chamber of Commerce (1956) 55 ITR 722 (SC)* held that the advancement or promotion of trade, commerce and industry leading to economic prosperity enured for the benefit of the entire community. That prosperity would be shared also by those who were engaged in a trade, commerce and industry. But on that account the property was not rendered any thing less than an object of general public utility. So, when the principal object of a chamber of commerce was to promote and protect trade, commerce and industry and to aid, stimulate and promote the developement of trade, commerce and industry in India or any part thereof, the Supreme Court held that the said object was of general public utility.

In the above-noted case the Supreme Court, while discussing the meaning of the expression "charitable purpose" observed as follows :

"Charitable Purpose" includes not only relief of the poor, education and medical relief alone, but advancement of other objects of general public utility as well. Section 2 (15) is intended to serve as a special definition of the expression "charitable purpose" for the Act. It is again inclusive and not exhaustive or exclusive. Even if the object or purpose may not be regarded as charitable in its popular signification as not intended to give relief to the poor or for the advancement of education or medical relief, it should still be included in the expression 'charitable purpose' if it advances an object of genral public utility *The expression "object of general public utility", however, is not restricted to objects beneficial to the whole of mankind An object beneficial to a section of the public could also be treated as an object of general pub'ic utility.* To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of the community sought to be benefited must undoubtedly be sufficiently defined and identifiable by some common quality of a public or impersonal nature; where there is no common quality uniting potential beneficiaries into a class, it may not be regarded as valid

The Bombay High Court held in *Bar Council of Maharashtra v CIT (1980) 126 ITR 27 (Bom)* that the word "general" in Section 2 (15) means pertaining to a whole class, the word "public" means the body of people at large and the word "utility" means usefulness. Thus, the advancement of any object beneficial to the public or a section of the public as distinguished from an individual or group of individuals would be a charitable purpose. The State Bar Council was held to be a body constituted for general public utility whose income would been entitled to exemption under Section 11. The Supreme Court affirmed the decision of the High Court when the case came up in appeal in *CIT v Bar Council of Maharashtra (1981) 130 ITR 28 (SC).*

The Finance Act 1983 has omitted the words "*not involving the carrying on of any activity for profit* "appearing at the end of Section 2 (15) with effect from Assessment Year 1984/85. The effect of this amendment is that a trust will be treated as a charitable trust under section 2 (15) even if its object involves the carrying on of an activity for profit. Such a trust will not be denied exemption under Section 11 on the ground that its objects are non-charitable.

Application and accumulation :

We have seen above that the exemption is limited to the extent to which such income is applied in India or outside India as the case may be. Is it necessary that the *entire* income should be so applied ? The Act gives a concession here. It is possible to claim the exemption even if the trust or institution applies only 75% of the income derived from the trust property for the purposes of the trust, during the relevant previous year.

An accumulation not exceeding 25 per cent of the income from such property is permissible. For computing this 25 per cent, the voluntary contributions referred to in section 12 shall be deemed to be part of the income. It must be clearly noted that such accumulation must be with the object of application of the accumulated amount to charitable or religious purposes in India at a later date. Such a facility for accumulation is not available for those trusts whose income is to be applied outside India.

Inability to apply in full 75 per cent of the income : It is clear from the above discussion that free accumulation not exceeding 25 per cent of income from property is permissible. Hence the balance 75 per cent must be applied during the previous year for the purposes for which the trust has been created. However it is possible that the trust is unable to apply the minimum of 75 per cent of its income during the previous year due to either of the following reasons.

(1) The whole or any part of the income has not been received during that year

(2) Any other reason.

In the first class of cases the period of application is extended to cover the previous year in which the income is actually received and the previous year immediately following that year. But the amount which may be so claimed to have been so applied during the subsequent previous year cannot exceed the amount of the income which had not been received earlier but received during a subsequent previous year.

Example—1 During the previous year 1980 a charitable trust earned an income of Rs. 1,00,000 but it received Rs. 60,000 only in 1980. The balance of Rs. 40,000 is received in 1982.

	Rs.
Total income earned in 1980	1,00,000
Actual receipt in 1980	60,000
Permissible accumulation @ 25% of Rs 1,00,000	25,000
Balance applied during 1980	35,000
Balance yet to be applied	40,000

Since this amount of Rs. 40,000 is received in 1982, this can be applied in 1982 or in 1983. If the full amount i e Rs. 40,000 is duly spent in these two years, the exemption is fully enjoyed but if only a part is so spent within the period, the exemption is restricted to that part only.

There may be a case where the inability springs from some other reason e.g. late receipt of the income making it impossible to spend it before the end of the year.

Ex. 2. A trust receives a sum of Rs. 50,000 on 30th March, 1981. Its previous year ends on 31.3.1981.

It is obvious that it is impossible to apply the requisite sum within one day. Therefore it has been provided that such sum can be applied at any time during the immediately following previous year i.e upto 31.3.82.

Formalities : To avail the facility of the extended period of application of income, the trust has to exercise an option in writing that the income applied later as prescribed may be deemed to be income applied to the relevant charitable purposes during the previous year in which the income was derived.

Such option has to be exercised before the expiry of the time allowed statutorily or of the extension under Section 139(1) or 139(2) for submission of the return allowed by the ITO.

The income so deemed to have been applied shall not however be taken into account in calculating the amount of income applied to such purposes, during the previous year in which the income is actually received or during the immediately following previous year as the case may be. Thus, in the example 1 given above, the amount of Rs. 40,000, received subsequently in the year 1982 and applied to charitable purposes either in the year 1982 or 83, will, by virtue of the option exercised by the trust, be deemed to be the income applied for charitable purposes in the year 1980 itself. However such an amount will not be taken into consideration in determining the amount of income applied for charitable purposes in the year 1982 or 1983, as the case may be.

Sub section (1B) of Section 11 provides that where the income for which an option has been exercised as discussed above, is not actually applied, it is to be treated as the income of the previous year immediately following the year of receipt or the previous year in which it was derived as the case may be.

Conditional accumulation : Apart from the provision for free accumulation upto 25 per cent, a trust has also got the rights for conditional accumulation. The relevant provisions are contained in Section 11(2).

Where seventy-five per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India but is accumulated or set apart either whole or in part for application to such purposes in India, such income shall not be included in the total income of the previous year if the following conditions are satisfied.

(1) A notice in writing is given to the ITO in the prescribed manner specifying the purpose for accumulation and the period for which the income is to be accumulated or set apart. Such period should not exceed ten years in any case.

(2) The money so accumulated or set apart should be invested or deposited in the following modes.

(1) Investment in Govt. Savings Certificates.

(2) Deposits with Post Office Savings Bank.

(3) Deposits with Scheduled banks or cooperative banks.

(4) Investments in the units of Units Trust of India, 1963.

(5) Investments in Central or State Govt. securities.

(6) Investment in debentures issued by or on behalf of any company or corporation. However both the principal and interest thereon must have been guaranteed by the Central or the State Government.

(7) Investment or deposits in any government company.

(8) Investment in bonds of approved financial corporations providing long-term finance for industrial development.

(9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes.

(10) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.

where the income of the trust.

(a) is applied to purposes other than charitable or religious purposes or

(b) ceases to be accumulated or set apart for application thereto or

(c) ceases to remain invested or deposited in any of the modes mentioned above or

(d) is not utilised for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 10 years) or in the year immediately following thereof.

Such income shall be deemed to be the income of the previous year in which it is so applied or ceases to be so accumulated or set apart or ceases to remain so invested or deposited or as the case may be, of the previous year immediately following the expiry of the period aforesaid.

It is possible that due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in approved modes cannot be applied for the purpose for which it was accumulated or set apart. In such a case an application may be made to the Income Tax Officer specifying such other purposes as are in confirmity with the objects of the trust. The ITO may allow the application of income to such other purposes. In such a permission being granted by the ITO, the new purposes will be deemed to be purposes specified in the written notice given to the ITO (mentioned above).

Where trust property consists of a business undertaking : Section 11(4) clarifies that for the purposes of Section 11, property held under trust may consist of a business undertaking so held. If that be so, the trustees may claim that the income of such undertaking enjoys exemption under section 11. Section 11(4) provides for two things.

(1) The ITO shall have the power to determine the income of the undertaking in accordance with the provisions of the Act relating to assessment, and

(2) Where the income determined by the ITO is in excess of that shown in the books of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes and accordingly be deemed to be the income of the previous year in which it has been deemed to have been so applied.

The Finance Act 1983 has also inserted a new sub-section (4A) in Section 11. Consequently a charitable trust engaged in business activity will be liable to pay tax on income from this activity. The trust will *not* lose its exemption under Section 11 in respect of its *other income if the* trust maintains separate books of account for its business activity. In respect of business income a trust can claim exemption only in the following cases :

(1) A trust established wholly for religious purposes can carry on the business of printing and publication of books or publication of books.

(2) The above trust can also carry on any other business as may be notified by the Central Government.

(3) An institution established wholly for charitable purposes can carry on a business involving work which is mainly carried on by the beneficiaries of the institution.

Transfer of capital asset : Section 11(1A) provides that where the entire proceeds of the transfer of the capital asset are utilised in acquiring a new capital asset which is held under trust wholly for charitable or religious purposes, the entire amount of capital gains arising from the transfer is to be deemed to have been applied to charitable or religious purposes If, however, only a part of the net consideration is utilised in acquiring the new capital asset, the amount of the capital gains deemed to have been utilized for charitable or religious purposes shall be equal to the excess of the proceeds utilised over the cost of the asset transferred.

Example Original cost of capital asset transferred		Rs. 1,00,000
Consideration for which it is transferred		Rs 1,50,000
Situation 1. Cost of new capital asset acquired	1,50,000	
Situatiuo 2. Cost of new capital asset acquired	1,20,000	

Amount that will be deemed to have been applied for charitable purposes.

Situation 1	Rs. 50,000
Situation 2	Rs. 20,000

Capital asset held under trust in part only for charitable and religious purposes : where such a capital asset has been transferred, only the "appropriate fraction" of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes Where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain will be deemed to have been applied. In any other case the exemption will be limited to so much of the appropriate fraction of the capital gain as is equal to the amount by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

"Appropriate fraction" here means the fraction which *represents the extent to which* the income derived from the capital asset transferred was applicable to charitable or religious purposes before such transfer.

Ex. A capital asset is being held under trust. Two-thirds of the income derived from such capital asset are being utilised for the purposes of the trust. The asset is being transferred.

	Rs.
Cost of transferred asset	1,20,000
Net consideration	1,80,000
Cost of new asset acquired	1,50,000
Capital gains	60,000
Appropriate fraction	2/3
Income represented by 'appropriate fraction'	2/3 (180000—120000) =Rs. 40,000.

Since the entire net consideration has not been utilised in acquiring the new asset the amount deemed to have been utilised for charitable purposes will be

2/3 (150000 −120000)=2/3(30,000)=Rs. 20,000

Any voluntary contributions received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes shall, for the purposes of Section 11, be deemed to be income derived from property held under trust wholly for charitable or religious purposes. Such voluntary contributions do not include contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Ex. A hundi kept in a temple to enable the devotees to offer their voluntary contributions contains the following inscription "contributions in this hundi will form part of the corpus of Shri Swaminathaswami temple trust". Now, the voluntary contributions will not be treated as income derived from property since they are receipts on capital account. Regarding their application, they can be utilised to create another property which would also be held in trust. For example, the above voluntary contributions can be utilised for building a manda for conducting special pujas for the deity.

Registration of trusts etc : The exemptions contained in Sections 11 and 12 as explained above shall not apply in relation to the income of any trust or institution unless the following conditions are satisfied.

(1) The person in receipt of income should make an application for the registration of the trust in the prescribed from (Form 10A) and in the prescribed manner to the commissioner before 1-7-73 or before the expiry of a period of one year from the date of the creation of the trust whichever is later. The commissioner may admit an application for the registration of any trust after the expiry of the aforesaid period.

(2) Where the total income of the trust without giving effect to the provisions of Sections 11 and 12 exceeds Rs. 25,000, the accounts of the trust must be audited by a chartered accountant. The report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such prescribed particulars should be furnished along with the return.

Sections 11 and 12 not to apply in certain cases : The exemption in respect of income from property, as enumerated above, will be forfeited in the following cases :

1. Where the property is held under a trust for private religious purposes, no part of the income will be exempt if it does not ensure for the benefit of the public.

2. Where a trust has been established after the benefit of any particular religious community or caste, the income thereof will not be eligible for exemption. Explanation 2 to Section 13 provides, however, that a trust or institution created or established for the benefit of scheduled caste, backward classes, scheduled tribes or women and children shall not be treated as a trust or institution created or established for the benefit of a religious community or caste within the meaning of Section 13 (i) (b) (i) Where the trust or the institution has been created or established after 31.3.1962 if any part of its income ensures directly or indirectly for the benefit of any person referred to in Section 13(3).

(ii) Irrespective of the date of the creation of the trust or the establishment of the institution, if any part of its income or any property belonging to it during the relevant previous year *used or applied* directly or indirectly for the benefit of any person referred to in section 13(3) Where a trust or institution created prior to 1.4.62 applies any part of such income or any property of the trust for the benefit of any person referred to in section 13(3) and such application is by way of compliance with a mandatory term of the trust then the exemption will not be denied.

Where a religious trust (created before the commencement of the Act) applies any part of such income or any property of the trust for the benefit of any person referred to in section 13(3) before 1.6.70, then also exemption will not be denied.

Prohibited Use or Application : We have noted above that when any part of the income or any property of the trust whenever created, is during the previous year, used or applied, directly or indirectly, for the benefit of any person referred to in Section 13(3) the denial of exemption operates. Now Section 13(2) of the Act specifies a

few particular instances where the income or the property is to be deemed to have been used for the benefit of a person referred to in Section 13(3). It should be noted that these particular instances do not in any way restrict the general meaning of the expression "used or applied for the benefit of a person". The provisions of section 13(2) are as follows.

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in Section 13(3) in the following cases--

(a) If any part of the income or property of the trust or institution is or continues to be lent to any person referred to in Section 13(3) for any period during the previous year without either adequate security or adequate interest or both.

(b) If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in Section 13(3) for any period during the previous year without charging adequate rent or other compensation.

(c) If any amount is paid out of the resources of the trust or institution to any of the persons referred to in Section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services.

(d) If the services of the trust or institution are made available to any person referred to Section 13(3) without adequate remuneration or other compensation.

(e) If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in Section 13(3) during the previous year for a consideration which is more than adequate.

(f) If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in Section 13(3) during the previous year for a consideration which is less than adequate

(g) If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in Section 13(3), provided the aggregate value of such income and property diverted exceeds Rs. 1,000.

(h) If any funds of the trust or institution are or continue to remain, invested for any period during the previous year (not being a period before the 1st day of Jan. 1971) in any concern in which any person referred to in Section 13(3) has a substantial interest.

Section 13(4) provides some respite where the aggregate of the funds invested in the said concern does not exceed five per cent of the capital of that concern. In such a case the exemption under Section 11 will be denied only in relation to such income as arises out of the said investment. The mere fact of some investment, however small in a case like this, will not result in a denial of the benefit of exemption in respect of the entire income.

Prohibited category of persons : Section 13(3) gives the list of persons, use or application of the income or property of a trust for whose direct or indirect benefit

results in a denial of the exemption contemplated in section 11 for a charitable or religious trust or institution. The said persons are as follows:

(1) The author of the trust or the founder of the institution.

(2) Any person who has made a substantial contribution to the trust or institution, that is to say any person whose total contribution upto the end of the relevant previous year exceed Rs. 5,000.

(3) Where the author, the founder or the person making a substantial contribution is HUF, any member of the family.

(4) Any trustee of the trust or manager (by whatever name called) of the institution.

(5) Any relative of any such author, founder person, member, trustee or manager as referred to in (i), (ii) (iii) and (iv) above.

The expression "relative" has been defined in Explanation 1 to section 13 in relation to an individual the expression means—

(a) spouse of the individual.

(b) brother or sister of the individual

(c) brother or sister of the spouse of the individual

(d) any lineal ascendant or descendant of the individual

(e) any lineal ascendant or descendant of the spouse of the individual.

(f) spouse of a person referred to in (b), (c), (d) or (e) above

(g) any lineal descendant of a brother or sister of the spouse of the individual.

(h) Any concern in which any of the persons referred to (i), (ii), (iii), (iv) and (v) above as a substantial interest.

Substantial interest in a concern : Section 13(2) (h), section 13(3) (e) and section 13(4) refer to cases [illegible] has a substantial interest in a concern. These references occur where the [illegible] or application" and "Prohibited category of persons" [illegible]. The circumstances, in which a person shall be deemed to have a substantial interest in a concern have been laid down in Explanation 3 to section 13 and [illegible] below :-

(i) When the concern is a company, a person shall be deemed to have a substantial interest therein, if its shares, other than preference shares, carrying not less than 20 per cent of the voting power are, at any time, during the previous year, owned beneficially by him alone or partly by him and partly by one or more of the other persons referred to in section 13(3).

(ii) When the concern is not a company, he shall be deemed to have a substantial interest therein, if he is entitled, or he and one or more of the other persons referred to in section 13(3) are entitled in the aggregate, at any time during the previous year, to less than 20 per cent of the profits of such concern.

Denial of exemption in cases of non investment of funds in approved channels :

Lastly Section 13(1) (d) denies the benefit of exemption in the following three circumstances.

12.2 Revocable Transfer of Assets and Transfers irrevocable for a Specified Period (*Sections 61, 62 and 63*) : All income arising to any person by virtue of a transfer of assets under a settlement, trust arrangement or other [illegible] deemed to be income of the transferor in any of the following conditions :

(a) if the transfer is revocable ;

(b) if the deed of transfer contains any provision for the direct or indirect re-transfer [illegible] part [illegible] or assets to the tranferor

(c) if it [illegible] assume power directly or indirectly over [illegible] transferred.

Exemption [illegible] to a transfer which satisfies all the following [illegible]

1. The transfer [illegible] time of the beneficiary [illegible] time of the transfer [illegible] made before 1-4-1961 for a period of [illegible]

2. The deed of transfer [illegible] direct or indirect re[illegible] assets to the transferor [illegible].

(3) The transfer [illegible] re-assume power directly or indirectly [illegible] of the income or assets during the aforesaid [illegible]

4. The transferor [illegible] indirect benefit from the income or the assets.

The provisions of Section 61 [illegible] with either the power of revocation [illegible] given (in the exception) above [illegible] for this [illegible] power of revocation is actually exercised [illegible] liability to tax from the beneficiary to the settlor [illegible] change the character of the income or bring to charge [illegible] exempt from tax under any other provisions of the Act. [illegible] partly taxable, the liability under this section [illegible] only in respect of that part of the income which is taxable.

Even if a settlement or transfer is revocable, [illegible] defined in Section 63(a), the income from the assets transferred would not be [illegible] in the total income of the transferor if all the four conditions stated above in the exemption are complied with. However, where the settlor receives a part of the income as a beneficiary but receives no direct or indirect benefit from the balance of the income paid to the other beneficiaries, and the trust is irrevocable for the period specified in Section 62, the income paid to the other beneficiaries cannot be included in the total income of the settlor. Similarly, if the trustees. (Who may also be the settlors) under a general power to make loans or advance moneys on normal commercial terms to a company in which the settlors are interested, whether substantially or otherwise, do so, it cannot be said that the settlors derive an indirect benefit from the trust. Consequently, the trust

income cannot be included in the total income of the settlors. Likewise, where a husband makes a settlement for the exclusive and independent maintenance of his wife, he cannot be said to derive any direct or indirect benefit from the settlement merely because he is under a legal obligation to maintain her and as such the provisions of Sections 61 or 62 are not applicable to such cases. Where the benefit received by the settlor is so illusory, slight or meager as to be considered negligible, it would not amount to receiving direct or indirect benefit and as a result Section 61 cannot be applied to such a case. For this purpose, the value of the benefit actually derived (but not notional) by the assessee alone should be taken into account.

In the case of trusts which are irrevocable, the question of direct or indirect benefit derived by the settlor or the absolute, conditional or contingent nature of the power of revocation is immaterial for consideration. It is not also necessary that the power of revocation should be exercised by the settlor himself. In other words, a trust which is irrevocable at the settlor's instance but is revocable by the trustee would also be a revocable trust. When once there is a re-transfer of income or assets to the settlor or the right to re-assume power is exercisable by the settlor the irrevocable trust would become revocable and the settlor would become liable to tax on the income of the trust. However, a trust would not become revocable merely because the income of the trust under the settlement is to be applied to or in payment of the debts of the settlor because such a provision in the deed cannot be construed as one for the indirect transfer of income to the settlor or re assumption of power over the income of the trust.

Thus in all cases where the transfer is revocable and the transferor gets (i) any direct or indirect benefit from the trust or (ii) a right to reassume power the income from the transfered assets will be included in transferor's total income and taxable in his hands. For this purpose, 'transfer' includes any settlement, trust, covenant, agreement or arrangement. The provisions of Sections 60 to 63 apply to all assessees including companies.

13. Income of Spouse, Minor Child etc; to be included in the Assessee's Total Income [Section 64 (1)]: This Section is intended to foil the attempts of an *individual* to avoid or reduce the incidence of tax by transferring assets to his spouse or minor child or admitting the spouse as a partner or admitting the minor child to the benefit of a partnership or by transfer of assets to certain other specified relatives.

In computing the total income of any individual, the following income will also be included.

(1) All income which arises directly, or indirectly, to the *spouse* of such individual from the membership of the spouse in a firm carrying on a *business in which individual is a partner* - Section 64 (1) (i). In the case of a *professional* firm, where both the husband and wife are partners, each of them would be assessed separately in respect of his or her share of the firm's income.

Where both the husband and the wife are partners in the same firm, for the purposes of aggregation of income from partnership, under Section 64 (1) (i) the income of the

spouse must be added to that of the husband or wife whose total income (excluding the income from the firm) is greater. This is made clear in Explanation 1 to Section 64 (1).

Explanation 1 A to Section 64 (i) makes it clear that where the spouse of an individual is a beneficiary under a trust and the trustee joins any partnership business with individual, the income arising from such partnership to the trust to the extent it is for the benefit of the spouse, will be included in the total income of the individual.

(2) All income which arises directly or indirectly to the *spouse* by way of salary, commisson, fees or other form of remuneration in cash or in kind from a concern in which such individual has substantial interest. Section 64 (1) (ii). Explanation 1 to Section 64 (1) makes it clear that with effect from 1-4-1980 the income arising to the spouse by way of salary, commission, fees or any other form of remuneration from a concern in which both the individual and the spouse have substantial interest will be included in the total income of the individual or the spouse whose total income excluding such salary commission, etc. is greater.

This provision, however, will not be applicable to the income of the spouse of an individual, earned by virtue of technical or professional qualifications and which is solely attributable to be application of such technical or professional knowledge and experience, from a concern in which such individual has a substantial interest. For this purpose, an individual shall be deemed to have a substantial interest in a concern—

(i) in case where the concern is a *company*, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) *i.e.* equity shares carrying not less than 20 per cent of the voting power *at any time* during the previous year owned beneficially by such person or partly by such person *and* partly by one or more of his relatives:

(ii) in any other case, if such person is entitled or such person *and* one or more of his relatives are entitled in the aggregate, *at any time* during the previous year, do not less than twenty percent of the profit of such concern.

Again, for the purpose of this provision, the term, 'relative' is defined in Section 2 (41) so as to cover the husband, wife, brother, or sister or any lineal ascendant or descenant of an individual.

(3) All income arising to the *minor child* of the individual from the admission of the minor to the benefits of partnership in a firm-Section 64 (1) (iii). It is to be noted that according to this provision, the income of the minor child arising from admission to the benefits of partnership in all cases will be included in the income of parent who *has the higher income.* In other words, this clubbing will take place *even though neither of the parents is a partner in that firm.*

The share income of the minor child should be included in the total income of that parent whose total income (excluding the income of the minor child from the firm, under Section 64 (1)(iii) *is greater than that of the other.* Even where the minor child has

an income in his or her own right, other than the share income from the firm, the share of income from the firm must be added to that of one of the parents whose income is greater. Still further where any such income has once been added to the total income of the spouse or parent in any previous year the same practice should be followed in the subsequent year also, though it can be altered later on by the Income-tax Officer if he finds that such a change is necessary after giving the other spouse or the parent a reasonable opportunity of being heard. This is made clear in Explanation 1 to 64 (1).

Explanation 2A to Section 64 (1) provides that, where the minor, child of an individual is a beneficiary under a trust and the trustee joins in any partnership business with any person, the income arising from such partnership to the trust, to the extent it is for the benefit to the minor child, will be included in the total income of the individual.

The provision stated above in regard to the treatment of income of spouse or minor child from a firm are absolute and qualified having no exception. The fact that the spouse or minor child is only a dormant partner or partner only by name does not affect the liability to tax under the Section. However, if one of the spouse is only an employee or agent of the firm or if one of the spouses or the minor child receives the income from the firm by virtue of any other contract with the firm (*e.g.*, interest, royalties, fees or commission) the provisions of this Section 64(1) (i) or (iii) cannot be invoked so as to include the income of the recipient in the total income of the spouse or parent.

Where the child admitted to the benefits of partnership is not a minor or only an illegitimate child of the individual or the minor child is purported to be admitted as a fulfledged partner in the firm then the income arising to the spouse or minor child shall not be included in the total income of the individual. However, where a minor married female child is admitted to the benefits of a firm in which both her father and her husband are partners, her share of the firm's income should be included in her father's (and not husbands's) total income. The provision of this Section would be attracted (a) whether or not the assessee's spouse or minor child is allowed a share in the firm without any contribution on their part to the capital or assets of the firm, or (b) whether they become members of the firm to their own right or in a representative capacity.

(4) All income, other than income falling under (1) above, which arise directly, or indirectly to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual, otherwise than for adequate consideration or in connection with an agreement to live apart—Section 64(1) (iv). This is, however, subject to the provisions of Section 27 (i) governing house property transferred to the spouse.

(5) All income, other than income falling under (1) above, which arises to the minor child (not being a married daughter) or such individual from assets transferred directly or indirectly, to the minor child by such individual under Section 64 (1) (v). This is also again subject to the provisions of Section 27 (1) governing house property transferred to the minor child.

Where the asset transferred is a house property the income from which is chargeable to tax under Section 22 and the transfer is made (i) to a spouse otherwise than for adequate consideration or in connection with an agreement to live apart or (ii) to a minor child (not being a married daughter) without adequate consideration, the transferor is deemed under Section 27 (i) to be the owner of the property and is assessable accordingly in respect of the income from the property. However, where the wife constructs a house out of money gifted by her husband and the income from the house property assessable in the hands of the husband is to be computed on the basis of the wife being the owner, and consequently if she resides in the house the limits prescribed for restricting the annual value of the house under Section 23(2) should be determined on the basis of her total income. The income arising from the assets transferred would be included in the total income of the transferor irrespective of the fact whether the income is derived from the asset in the *original form in which it was transferred* or in a different form.

Explanation 3 to Section 64(1) provides that if *the spouse or minor* child to whom the assets are transferred by the individual has invested the same or a part thereof in *any business, the* proportionate income of such business attributable to such investment *will be* clubbed *with the income of the individual.* The effect of this *Explanation is that the income from investment of transferred* assets need not arise from a proximate source for the purpose of clubbing the income. To this extent the Explanation negatives the effect of the decision of the Supreme Court in the case of *C.I.T. v. Prembhai Parekh and others 71 I.T R. 27 (S C.)* For the purpose of finding out the proportionate income the total value of the assets transferred to the spouse or minor child will be compared with the investment by such spouse or minor child in the said business as on the first day of the accounting year. The proportionate income from the business will be considered as having arisen from the assets transferred by the individual. Thus, if a person has given a gift of Rs. 1 lac to his wife and she has invested this amount in any business carried on by her the entire income of the business will be clubbed with the income of the husband. If in this case the wife has her personal funds and besides the above investment of Rs. 1 lac she has also invested a further amount of Rs. 1 lac from her own resources in the above business and the position on the first day of the previous year shows that her total investment in the business is of Rs. 2 lac which includes the amount of 1 lac received from her husband by way of gift then only 50% of her income from business will be clubbed with the income of the husband. It is to be noted that the provision is applicable only if the investment is made in any *business*. If the investment is made for carrying on any 'profession' this fiction will not apply.

(6) All income which arise to the son's wife (daughter-in law) or son's minor child (grand-child) of the individual from assets transferred by the individual direcly or indirectly *on or after 1st June 1973*, otherwise than for adequate consideration– Section 64 (1) (vi). This is a new area of clubbing applicable to transfers effected on or after 1st June, 1973.

It is significant to note that the above provisions do not apply to a trust created for the benefit of a son's wife or a son's minor children. Thus, the income of trust

created for the benefit of daughter-in-law or grand children will not be clubbed with the income of the settlor. Similarly, the above provisions do not apply to transfer of assets to son-in-law or to the minor children or daughter. Gift made to a lady before she marries the son of an assessee or to a child before his adoption by the son of the assessee will also be outside the scope of these provisions. It is to be noted that this provision would also cover cases of transfers to son's minor married daughter.

(7) All income which arises directly or indirectly, to any person or association of persons from assets transferred *directly or indirectly*, otherwise than for adequate consideration to the person or association of persons by such individual, *to the extent to which the income from such assets is for the immediate or deferred benefit of his or her spouse or minor child not being a married daughter or both* – Section 64 (1) [vii].

It is significant to note that the Explanation 3 to Section 64 (1) does not extend to income arising from transfer of assets to daughter-in-law and grand children covered by Section 64 (1) (vi) and to income of trusts created for the benefit of spouse and minor children under Section 64 (1) (vii). Therefore, if the assets gifted to daughter-in-law or grand children are invested by them in any business, income derived from such business will not be treated as income from such transferred assets and the principle laid down by the Supreme Court in the case of *Prembhai Parekh's* case in 77 I.T.R. 27 will hold good in respect of transfers under Section 64 (1) (vi).

In cases where the income is included in the income of another person under the provisions of Section 64 (1), the income flowing out of the investment of such included income will not be so clubbed Similarly, the clubbing provisions will not cover income arising from accretions to the assets transferred. The amount to be included in the total income of the transferor should be either the income arising directly or indirectly from the asset transfered or capital gains arising from the transfer but not the income arising from the accumulated income or from accretions to the assets transferred. Thus, if an individual transfers shares to his minor son, bonus shares received by the son in respect of his shareholding would not be assets transferred by the individual to his son but would constitute *accretions* to the assets transferred and consequently the dividend on the bouns shares cannot be included in the total income of the father. The income includible in the total income of the transferor is only the income actually arising from the asset transferred but not the income which may be deemed to accrue or arise under any provision of the Act. For purposes of applying this Section the relationship between the transferor and the transferee, in case of transfer to the spouse, should be legally that of a husband and wife not only at the time of accrual of income but also at the time of transfer. Thus pre-nuptial transfer will not come within the purview of this proviso. Where the transfer is to a minor child the provisions of this Section would apply irrespective of the fact whether the transfer is made for the immediate or deferred benefit of the minor. But if the income during minority is to be accumulated and added to the corpus and the income therefrom is to be given to the minor on his attaining majority, the income so accumulated or given to the minor cannot be included in the income of the parent. This section would not also apply after the minor child attains majority or if the minor child who is a female gets married.

Thus, a transfer, in order not to attract this section, should be made not merely for good consideration but necessarily for adequate consideration. It is worthwhile to note that natural love and affection will not constitute adequate consideration and as such transfer made on considerations of love and affection would still be covered by this section The benami incomplete or illegal nature of the transfer or the income would not, in any way, effect the liability of the transferor under this Section.

13.4 **Cross Transfers** : In the case of cross tranfers also (*e.g.* A, making a gift of Rs. 50,000 to the wife of his brother B, for the purchase of a house by her and simultaneous gift by B to A's minor son of shares worth Rs. 50,000 owned by him). the income from the assets transferred would be assessed in the hands of the transferor even if (i) the transfers are so intimately connected as to form part of single transaction and (ii) each transfer constitutes consideration for the other being matual or otherwise. Thus, in the instant case the transfers have been made by directly by A and B to persons who are not their spouse or minor child so as to circumvent the provisions this Section, showing that each transfer constitutes consideration for the other. The Supreme Court in the case of *C.I.T. v. Keshavji and Morarji and another (1967) 66 I.T R. 142* held on similar circumstances that cross transfers of an indirect nature would thus be brought under this Section. Accordingly, the income arising to Mrs. B from the house property should be included in the total income of B (and not A) and the dividends from shares transferred to A's minor son would be taxable in the hands of A (but not B). This is because A and B become the indirect transferors to their minor child and spouse, respectively of the assets yielding various amounts of income so as to reduce the burden of taxation.

13.5 **Conversion of self acquired property into the property of a Hindu undivided family or gift of property to HUF** [Section 64 (2)] : Section 64 (2) deals with case of conversion of self-acquired property into property of a Hindu undivided family. The provisions of Section 64 (2) as amended upto date, are summarised below :—

(1) Where and individual converts at any time *after 31-12-1969*, his separate property into property belonging to the Hindu undivided family of which he is a member by impressing such property with the character of the property belonging to the family or by throwing such property into the common stock of the family, the individual *shall be deemed to have transferred* the converted property to the members of the family for being held by them jointly. This provision will apply in all such cases notwithstanding anything contained in any other provision of the Income-tax Act or any other law for the time being in force.

(2) In computing the total income of such an individual, entire income from such converted property shall be included.

(3) With effect from 1st April 1980, the provisions of Sec. 64 (2) would also cover cases where an individual makes a transfer of his separate property directly or indirectly to his family otherwise than for adequate consideration. Consequently, in cases of such gifts one's separate property to the

HUF of which is a member the entire income from the gifted property i use included in the concerned's income.

(4) Where the converted property has been partitwned either by way of total or partition the income derived from such converted property as is receve by the spouse or minor child on partition will be deemed to arise to th *spouse or minor child* from assets transferred indirectly by the individual tc *spouse or minor child* an ! consequently such income shall also be include in the income of such individual.

(5) Where income from the converted property is included in the total income of an individual under Section 64(2), it will be excluded from the total income of the family, or, as the case may be, of the spouse or minor son of the individual. That part of the incom from the converted property which is not includible in the total income of the individual who effected the conversion should be taxed as the income of the H.U.F.

It must be noted that the above provisions will be applicable in all cases irrespective of the fact whether or not the Income-tax Officer is of the opinion that this will result in a benefit to the Revenue. Explanation to Section 64 (2) provides that for the purpose of this provision the term 'property' includes any interest in property (movable or immovable), the proceeds of the sale of such property and any money or investment which for the time being represent such sale proceeds and also any property converted from one species into any other property by any method.

Income for the purpose of Section (1) include Loss : Explanation 2 to Section 64 provides that, for the purpose of Section 64, 'income' would include 'loss'. Accordingly, where the specified income to be included in the total income of the individual is a loss it will be taken into account while computing the total income of the individual It is significant to note this explanation applies to the provision of both sub-section (1) and sub section (2) of Section 64.

For instance, if by virtue of the assets transferred without adequate consideration, transferee has incurred a loss, such a loss incurred by the transferee will have to be set off against the income of the transferor in his assessment. The set off of loss would however be subject to the conditions prescribed under Sections 70 to 80 of the Act. If for instance, shares have been gifted by an individual to his wife and the shares are later on sold by her at a price which is less than the cost of the shares for which they were acquired by the husband the loss computed would be regarded as loss under the head 'Capital gains' and such loss would be set off against the income of the husband in computing his total income for the assessment year relevant to the previous year in which the shares were sold.

The provisions contained in Sections 61 to 64, as discussed above are not mutually exclusive. In this connection it may be noted that the main distinction between the two sections is that Section 61 applies only to revocable transfer made by class of assessee while Section 64 applies to revocable as well as irrevocable transfers made only by individuals.

There seems to be a conflict of judicial opinion regarding the head under which income includible under *Sections 60 to 64 is to be assessed.* According to one view, *the included income retain* the same head under which it is earned. The decision of the Mysore High Court in *J H. Golia vs C.I.T. (1963) 91 I.T.R. (531)* support the view. On the other hand, the Bombay High Court's decision in *Keval Chand Mehta* vs. *C I T. (1968) 67 ITR 304* supports the view that the included income is always to be treated under the head "income from other source". It is submitted that the view of the Mysore High Court appears to be more rational.

For all purposes of aggregation under Section 64 the expression *'child'*, in relation to an individual must be taken to include also a step child and an adopted child of the individual. The definition of the term child is contained in sub section (15 A) of Section 2 which has been introduced in the Income-tax Act with effect from Ist April, 1976.

13.6 **Liability to Pay Tax on the Income included** (*Section 65*) : An assessee is chargeable to tax under Sections 60 to 64 in respect of income, which legally or beneficially belongs to another persons, by virtue of its inclusion in his total income. In all such cases, however, the real owner of the income so included shall be liable, on the service of demand by the Income Tax Officer, to pay the tax assessed and levied on the other person but attributable to his income. Thus, tax shall be recovered from the real owner of the income without an assessment being made on him. This Section confers on the Income tax Officer the power of discretion to recover the tax in respect of the income either from the assessee in whose total income the inclusion is made or from the real owner thereof. Where the asset yielding the income is jointly held by more persons than one, they shall jointly and severally be liable to pay the tax attributable to such income included in the total income of rnother.

14. AGGREGATION OF INCOME (*Sections, 66 to 69 D*)

14 1 Total Income (*Section 66*) : The scope of total income based upon the residential status of the taxpayer has been discussed earlier in this Study Paper under the head 'total income' under Section 5. This Section only enlarges the scope of total income by providing that the total income tax of an assessee shall include all income on which no income tax is payable under Chapter VII of the Act, *i. e.*, income which qualify for rebate at the average rate of tax. The tax deducted at source is also included in the total income of the person on whose behalf the deduction was made. Incomes exempt from being included in the total income under Sections 10 to 13 shall not be includible in the total income of an assessee whereas incomes which qualify for rebate or deduction or which are deemed to be the income of the assessee under Sections 60 to 63 shall be included in the total income. This Section is important in so far as (i) the tax liability of any assessee depends upon his total income and (ii) the deductions, rebates, reliefs *etc.*, have to be calculated with reference to the total income. The provisions of this Section are supplementary to, but not in substitution of Section 5 under which the scope of total income is determined.

The method of computing a partner's share in the income of the firm given in Section 67 of the Act is discussed in Study Paper IV while dealing with the assessment of firms and their partners.

14.2 Cash Credit (*Section 68*) : Cash credits which are not explained by the assessee to the satisfaction of the Income Tax Officer may be treated as the incomes of the assessee on the ground that such credits represent undisclosed income consisting of secret or suppressed profits made by the assessee from his regular business. Thus, if a sum is found credited in the books of account of an assessee maintained for any *previous year* (which need not necessarily be the financial year) the amount of cash credit must in all cases be treated as the assessee's undisclosed income of that *previous year* The financial year should not be taken as the previous year for such a cash credit even if the undisclosed income is not found to be from the assesee's regular business for which the books are maintained. However, before, taxing unexplained cash credit as the income of the assessee, the tax authorities should have reason to believe that the assessee could have earned income of a sum equal to or not less than the amount of cash credits which had not been explained by the assessee. Cash credits may be assessed as business income only if the credit is found in the assessee's business ; in all other cases they must be assessed as income from other sources.

14.3 **Unexplained Investments** (*Section 69*) : The value of an investment made by an assessee which (i) is not recorded in the books of account or (ii) is not explained by him to the satisfaction of the Income Tax Officer, or (iii) the explanation offered by him, in the opinion of the Income Tax Officer, is inadequate ; incorrect or illusory, may be assessed as his income. For this purpose, the *financial year* in which the investment is made shall be taken as the previous year for assessing the value of such investments. The assessment should be made irrespective of the fact whether or not the assessee could possibly have earned income sufficient enough to match with the value of the investment during the period between the commencement of the relevant financial year and the date of the investment. It is also immaterial to consider, for this purpose, the capital or revenue nature of the receipt forming the source of the investment or the source thereof—whether from business or other sources. Thus, though the investment may be a capital asset, it would become chargeable to tax as income under this Section.

14 4 **Unexplained Money** (*Section 69 A*) : Provides for the inclusion in the total income of an assessee the money, the value of buillion, jewellery or other valuable articles when such money, bullion, *etc.* do not either appear in the books of account or other records of the assessee or are not explained by him to the satisfaction of the Income Tax Officer. The provisions of this Section are similar to those of Section 69. The value of such money, bullion, *etc.*, is to be treated as the income of the *financial year* in which the assessee is found to be the owner thereof.

14.5 Undervalued or Undisclosed Investments *etc.* : *Section 69 B* aims at taxing undisclosed incomes represented by undervaluation of assets. According to this Section wherein any *financial year* the assessee has made invesments or is found to be the owner of any bullion, jewellery or their valuable article and the Income Tax Officer finds that the cost of these items shown by the assessee is less than the value which, in the opinion of the Income Tax Officer, should have been their real cost to the assessee and the assessee offers no explanation for the difference to the satisfaction of the Income Tax Officer, the Income Tax Officer can treat this difference as the

income of the assessee The amount of under-valuation should be treated as the income of the *financial year in* which the assessee is found to have made the investment or is found to be in possession of the asset.

14.6 Unexplained Expenditure (*Section 69*) : In cases wherein any financial year an assessee has incurred any expenditure and offers either no explanation about the source of such expenditure or a part thereof or the explanation, if any, offered by him is not, in the opinion of the Income Tax Officer, satisfactory, the amount covered by such expenditure or a part thereof, as the case may be, must be deemed to be the income of the assessee for such *financial year.* In all cases where any unexplained expenditure is to be treated as part of the taxable income under this Section, the accounting year for this income must be taken to be the *financial year* regardless of the accounting year followed by the assessee for his business, profession or other sources of income. This provision applies to corporate as well as non-corporate assessees alike.

14.7 Hundi Loans : Section 69 D of the Income-tax Act provides that in cases where any amount is borrowed on *hundi* form, or any amount due thereon is repaid to any person otherwise than through an account payee cheque drawn on a bank, the amount so borrowed or repaid must be deemed to be the income of the person borrowing or repaying the amount aforesaid for the accounting year in which the amount was borrowed or repaid, as the case may be. However, if in any case any amount borrowed on *hundi* has once been deemed under Section 69 D be the income of any person the same person shall not again be made liable to be assessed in respect of that amount under this provision at the time when the amount is repaid. For this purpose, the amount repaid must also be taken to include the amount of interest paid on the amount borrowed by the assessee.

For the purpose of assessment of *hundi* loans as the income of the assessee, it is essential that the borrowing or the repayment of the *hundi* loan must be through some form otherwise than by means of a cheque crossed 'A/c Payee' drawn on a bank. In case where the *hundi* loan is liable to be taxed, the accounting year for taxing that income in all cases be taken to be the same as the *accounting year* followed by the assessee for his business or profession or for the purposes of his other sources of income in connection with which the borrowing or repayment is made.

15. DOUBLE TAXATION RELIEF (*Sections 90 and 91*) :

Under Section 90, the Central Government is empowered to enter into agreements with foreign countries (i) for granting relief to assessees in respect of the double taxation of the same income and also (ii) for the avoidance of double taxation. Under these agreements an assessee is entitled to the relief granted provided that the conditions stated therein are satisfied. The relief is granted in the form of a reduction in the amount of taxes payable in India and is calculated on the basis of the income which is the subject of double taxation both in India and in the foreign country with which India has entered into such an agreement. India has entered into agreements for relief against or avoidance of double taxation with Ceylon (Shri Lanka) Switzerland, Sweden, Denmark, Norway, Japan, Federal Republic of Germany, Finland,

Austria, Greece, Romania, Lebanon, United Arab Republic, France, Iran, Italy, Belgium and Afghanistan.

Where the agreement with the foreign country is only for relief against double taxation and not for avoidance of double taxation, the assessee cannot claim any relief under this Section unless he proves to the satisfaction of the Income Tax Officer that the same income has been doubly taxed in the foreign country under thei ncome-tax law both in India and in the foreign country. This relief would be available to all assessees irrespective of their sources of income or residential status.

In the case of income arising to an assessee in countries with which India does not have any double taxation agreement, relief would be granted under Section 91 provided all the following conditions are fulfilled :

(a) The assessee is a resident in India during the previous year in respect of which the income is taxable.

(b) The income (whether agricultural or otherwise), in fact, accrues or arises to him outside India.

(c) The income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee.

(e) The assessee has paid tax on the income both in India and in the foreign count y before claiming the relief.

The relief would be given by way of a reduction from the income tax payable in in India. The amonnt of relief would be a sum calculated on the double taxed income (i) at the Indian rate of tax or the rate of the tax in the foreign country, whichever is less ; or (ii) at the Indian rate of tax, if both are equal "In order to claim the relief under this Section it is immaterial that the tax, paid in the foreign country by the assessee,' is in respect of income arising to him in another foreign country with which India has an agreement for relief from double taxation or avoidance of double taxation. In the case of a non resident assessee similar relief would be available to him in respeet of his share in the foreign income of a registered firm which is assessed as a resident in India. The conditions to be fulfilled by the assessee and the quantum of the relief are similar to the ones stated above in the case of residents

16 SPECIAL PROVISIONS TO CHECK AVOIDANCE OF TAX (*Sections 92 to 94*)

16.1. **Income from Transactions with Non-residents** : Under Section 92, all resident assessees, are chargeable to tax in respect of their income which is deemed to have arisen to them from their transactions with non-resident persons whether they (the latter) are assessable in India or not. For this purpose, the word 'non-resident' shall also inculde a person who is not ordinarily resident by virtue of the definition contained is Section 2(30). The resident assessee is deemed to have derived income under this Section in cases where it appears to the Income-tax Officer that owing to the close connection (in business or otherwise) between the resident and the non-resident, the course of the transactions is so arranged that the transactions between them

produce to the resident either no profits or less than the ordinary profit which might reasonably be expected to arise in that business.

The scope of the expression 'business connection' for this purpose has been explained by the Supreme Court in *C.I.T v. R.D. Aggarwal (1965) 56 I.T.R. 20.* The income so deemed to have been derived by the resident shall be determined by the Income-Tax Officer under Rule 11 of the Income-tax Rules, 1962 read with Rule 10 and included in his total income of the relevant previous year. Thus, in a case where two non resident shipping companies beneficially held the shares of an Indian company carrying on business as marine engineers and ship builders and, under an agreement entered into between the non resident foreign companies and the resident Indian company, the latter built and repaired the ships of the former at cost without charging any profit it was held that the Indian company was deemed to have derived income from the sale to and repair of ships of the non-resident foreign companies (*Mazagaon Dock Ltd. v. C.I.T. (1958) 34 I.T.R. 368 (S.C.)*]. The method of computing the income deemed under this Section is the same as described under Section 9 (1) (i) for computing the income deemed to accrue or arise in India in the case of a non-resident.

16.2 **Transfer of Income to Non-residents** : Section 93 hits at transactions which are effected with a view to avoiding liability to taxation. For the purpose, the word non-resident also includes a person who is not ordinarily resident. In order to attract the provisions of this Section, all the following conditions must be satisfied :

(a) There is a transfer of assets --whether immovable and whether tangible or intangible.

(b) The transfer is made by any person in India or outside irrespective of his residential status or citizenship.

(c) The transfer is made either alone or in connection with associated operations

(d) The assets transferred directly yield income chargeable to tax under this Act.

(e) The transfer of assets is effected in such a manner that the income becomes payable to a person outside India who is either a non resident or a not-ordinarily resident in India.

(f) The transferor acquires any right by virtue of which he gets the power to enjoy the income whether immediately or in future.

(g) The Income Tax Officer is satisfied that avoidance of liability to tax in India is the purpose of the transfers.

In particular, this Section deems any income of a non-resident person which, if it were the income of a resident person, would be chargeable to tax in India (in the absence of this Section), as the income of the resident person in India for all purposes of the Act provided that all the conditions stated above are satisfied. This Section also covers a variety of transactions constituting a transfer inculding cases where assets are transferred to a non-resident person and the transferor indirectly derives

income under the guide of obtaining loans or repayment of loans. If the aforesaid conditions are fulfilled, the income from the assets transferred should be treated as the income of the transferor and would accordingly be taxable in his hands. Therefore, where assets are transferred to a non-resident limited company, in consideration of shares alloted by it to the transferor, he (the transferor,) will become assessable under this Section in respect of the income of the company derived by it from those assets : by holding a sufficiently large number of shares, the transferor can be said to have acquired a right by virtue of which he has the power to enjoy the income of the company whether directly or indirectly and whether forthwith or in the future [*Chindambaram Chettiar v. C.I.T.* (1966) 60 *I.T.R. 28.(S.C.)*].

This Section will not, however, apply to cases where (i) the transfer is effected *bona fide* and for adequate consideration and (ii) it is proved to the satisfaction of the Income tax Officer that the transfer was effected for *bona fide* commercial purpose and with no intent to avoid tax.

The income which is deemed to be that of the transferor under this Section may arise either as a result of the transfer or in connection with associated operations. But in both the cases, the treatment of the income would be the same. The expression 'associated operation' in relation to a transfer as defined in sub section (4)(b) of the Section means an operation of any kind effected by any person in relation to :

(i) any of the assets transferred ;

(ii) any assets representing, whether directly or indirectly any of the assets transferred ;

(iii) any income arising from such assets ;

(iv) any assets representing, whether directly or indirectly, the accumulations of income arising from such assets ;

In order to determine the liability of the assessee in respect of the deemed income it is immaterial if the income or benefits from the transfer (i) are actually received or not or (ii) are received or are receivable in cash or kind or (iii) are receivable directly or indirectly. For purposes of this Section, a person is deemed to have the power to enjoy the income of a non resident if :

(i) the income, in fact, is so dealt with by any person as to be calculated at some point of time to ensure for the benefit of the transferor, whether in the same form of the income or otherwise;

(ii) the receipt or accrual of the income operated to increase value of any assets held by the transferor or for his direct *or* indirect benfit;

(iii) the transferor receive or is entitled to receive at any time, any benefit out of the income or out of any moneys available for the purpose either immediately or in future by reason of the effect or successive effects of the associated operations on that income and or the assets which represent the income ;

(iv) the transferor is in a position to obtain for himself the beneficial enjoyment of the income by exercising any power of appointment or power of r

tion or otherwise, whether with or without the consent of any other person, or

(v) the transferor is able to control directly or indirectly the application of the income in any manner whatsoever.

But in determining whether a person has the power to enjoy the income due regard shall be had to the substantial result and effect of the transfer and any associated operations must be taken into consideration irrespective of the nature or form of the benefits.

However, where an assessee has been charged to tax in respect of a sum deemed to be his income under this Section, the subsequent receipt of that sum by the assessee, whether as income or in any other form, shall not be liable to tax in his hands at the time of receipt.

16 3 **Transactions in Securities** : Section 94 aims at preventing avoidance of tax by assessee by sale or purchase of securities in different devices and under different circumstances. In all cases where there is a transfer of shares or securities whereby the transferor avoids tax or shifts the burden of tax to some other person, the income from the securities transferred shall be deemed to be that of the owner (being the transferor) and shall be assessable in his hands accordingly. In order to attract the provisons of the Section, the following conditions must co-exit as was held in *C.I.T. v Sakarlal Balabhai (1968) 69 I T.R. 186.*

(a) The transfer is of shares or secutities ;

(b) The income arising from the shares or securities is chargeable to tax as dividend of interest :

(c) The transferor is the legal or beneficial owner of, or a person having a beneficial interest in the shares of securites ;

(d) The income from the shares of securities becomes payable to a person other than the owner by virtue of the transfer ;

(e) The transfer may or may not have been effected for adequate consideration ;

(f) The assessee must effect the transfer deliberately with the intent to avoid tax. In other words, he must receive the amount which would have been liable to tax as his income but on which he avoids tax by some artifice or device.

Bond-washing transactions and cases of sales of securities and shares-cum-interest or cum-dividend would fall within the provisions of this Section. Income by way of interest on securities or dividends does not accrue day by day but on certain fixed dates or on the date of declaration, as the case may be. Accordingly, the seller of securities-cum-interest or shares-cum-dividends, on accrual of the interest, is not assessable on the interest or divieend income on the securities or shares sold by him since that part of the consideration received would be a part of the capital price realised on sale. As a result, if a person, on the eve of payment of interest, sells or otherwise transfers his securities to another and buys back or required the same after the

interest income had been received by the transferee, the transferor would escape tax thereon. This would amount to either total avoidance of tax or shifting the burden of tax by the transferor indirectly and transactions of this type are commonly known as bond-washing transaction. In order to prevent this type of avoidance of tax by assessee, sub-section (i) specifically provides that where the owner of any shares or securities sells or otherwise transfers them and then buys them back or otherwise requires them the interest or dividend received by the transferee shall be the income of the transferor.

Similarly, in cases where shares or securities are sold by the owner of such shares or securities or by a person having a beneficial interest therein and, as a result of the sale, the transferor receives either no income or less income from the securities or shares than that which would have been received by him, had the income from such securities accrued day to day and apportioned accordingly, then the income from securities of shares for such year shall be deemed to be the income from securities or shares for such year and shall be deemed to be income of the transferor. Thus sub-section (2) applies only to cases where (i) the income accrues or falls due periodically and (ii) the income in question is of a recurring nature though the interval of time between the two dates of accrual may not be equal (*e.g.* dividends). However, the notional dividends specified in Section 2(22) would not be covered by this Section and the assessment of such fictional dividends should be made only in the hands of the person who is entitled to the same and not in the hands of the transferor.

There is, however, *one exception* to both the above provisions given in sub-section (3). According to the exception, the provisions of sub-sections (1) and (2) would not apply (i) if there has been no avoidance of tax, or (ii) if the avoidance of tax is exceptional and not systematic *and* there has been no avoidance of tax by the assessee during the three years immediately preceding the previous year. It is for the assessee to prove to the satisfaction of the Income Tax Officer that there had been no avoidance of tax or that the avoidance of tax is exceptional and not systematic even though it may be suitably planned or devised and may be carried out by a number of sales at the same time.

Where any person carrying on business, wholly or in part, as a dealer in shares and securities buys or acquires any security and sells back or transfers the same, then, if the transaction results in the immediate or future receipt of the income from such shares or securities otherwise than as a bond washing transaction, the effects of the transaction shall be ignored for purposes of computing the business profits under this Act.

The Income-tax Officer has been empowered to issue a notice in writing requiring any person to furnish to him within a specified time (not being less than 28 days), in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period specified by him in the notice, such particulars as he may consider necessary for purposes of this Section and for the purpose of ascertaining whether tax has been borne in respect of the interest or dividends on all those securities or shares.

SELF-EXAMINATION QUESTIONS

1. Shri Carefree entered into business on 1st July, 1982. During the year ended 30th June, 1983 he received the following income :—

   (a) Commission on sale of sugar manufactured in the factory owned by X Ltd., in which the assessee's father is the Managing Director Rs. 50,000.

   (b) Rent from property settled in favour of the assessee by his father-in-law Rs. 50,000 (c) Profit from share speculations—Rs. 10,000. The assessee has maintained no accounts How will you advise him as regards the fixation of previous year for his first assessment under the Income tax Act for the year 1983 84 or 1984-85 ? Would your advice be different if he had made up his accounts on different dates in respect of each source of income ? (Section 3).

2. A made a gift of Rs 50,000 to the wife of his brother, B, for purchase of a house by her and simultaneously B transferred certain shares of the value of Rs. 50,000 owned by him to A's minor son. During the year ended 31st March, 1983 the chargeable income from the house property was Rs. 5,000 while the amount of dividends paid on the shares was Rs. 3,000. State giving reasons how and in whose hands these two items of income will be taxed (Section 64)

3. Mr. Merchant transferred a house valued at Rs. 5,00,000 to a private company for a nominal sum of Rs 1,00,000 on the understanding that the company would appoint his wife as the managing director of the company and allow her to live in it The entire shares of the company are held by Mr. Merchart. The A L V. of the house is Rs. 30,000 State the amount thereof which will be created as the income of Mr. Merchant, the company and the wife of Mr Merchant (Section 64).

4. An assessee who is carrying on a business, for and upto the year ended on 31st March, 1982 had been closing his accounts on 31st March every year. He wished to change his previous year from the year ending on 31st March to that ending on 31st December and with that view applied to the Income-tax Officer seeking his permission to that effect. The Income-tax Officer agreed to the change on the condition that the first previous year after the change shall be a period of 21 months commencing from 1st April, 1982 and ending on 31st December, 1983. Discuss the validity or otherwise of the condition prescribed by the Income-tax Officer (Section 3).

5. The board of directors of M/s. Raghavan & Co. Limited announced on 31.1.1983 that the company would pay an interim dividend of Rs. 10 per share on 1.3.1983. But due to certain unavoidable circumstances the dividend could not be paid until 30.6 1983. State with reasons whether the dividend must be treated as the income of the previous year ended on 31.3.1983 or that of the year ending on 31.3.82 (Section 8).

6. A carried on business since 1960 in Bombay and was dealing in a variety of articles including parachute silk. On 3.10.1982 he entered into a contract with the Taj Aircraft Ltd., which was acting as the agent of the Government, for the purchase of 1,30,000 parachutes belonging to the Government for a sum of Rs. 9,50,000. Since he did not have enough funds with himself to deposit by way of earnest money *i.e.* Rs. 10,00,000 under the contract he entered into a financial arrangement with B, C and D whereby the sum of Rs. 10 lakhs was to be deposited by the latter and they were to receive a net profit share of 60 paise in the rupee. On 12.11. 1983 the benefit of the contract was transferred to a firm and the financiers withdrew from the arrangement. A received Rs. 1,90,000 from the firm as consideration for the transfer on 15-1-83. Discuss whether A would be liable to tax in respect of the amount received by him whether wholly or in part. [*M.R. Goyal v. C I.T. (1969) 73 I.T.R. 698 (S.C.)*].
7. Mr. Raj Kapoor held 5,000 shares of Rs. 100 each fully paid up in the capital of Delhi Motors Ltd., of which he was a director. On 1-4-1982 he gifted out of his shareholding 1,000 shares to his only son Ravi who, at that time, was a minor. On 1-6-1982 the company passed resolution declaring the issue of bouns shares at the rate of one fully paid up share for every two shares held. The bonus shares were allotted to the shareholders on 30-9-1982. Ravi was alloted 500 bonus shares in respect of the shares held by him. For the year ended 31-3-1983 the company declared a dividend at the rate of 15 per cent, on all the shares. Consider how the dividend income of Ravi on the shares gifted to him and on the bonus shares allotted on that basis would be assessable for the year 1983-84. Would the position have been any different if—the bonus shares had been allotted first to Mr. Raj Kapoor and he had subsequently gifted them to his son ; or (ii) the shares were gifted by Mr. Raj Kapoor to his wife instead of his son (Section 64). [*Popatlal Bhikam Chand v. C.I.T. (1959) 36 I. T. R 577 (Bom)*]
8. A and his brother B carried on independent business at Madras and Bangalore, respectively. On 1-9-1981 A advanced a loan of Rs. 1,12,000 to B, free of interest which B invested in preference shares of a company on which dividends amounting to Rs. 32,000 were in arrears. On 12-3-1983 A wrote to B that the loan advanced by him need not be repaid. During 1983-84 B collected the arrears of dividend on the preference shares and credited the amount to his profit and loss account. Consider on the basis of the above facts—(i) Whether the sum of Rs. 32 000 is assessable as income ; and (ii) if so, whether it could be assessed as the income of A or that of B. (Sections 2 and 64) [*C.I.T. v. India Discount Co. Ltd.* (1970) 75 *I.T.R. (S.C)*]
9. Mr. A, a resident of Afghanistan came to India for the first time on 15th April, 1969. He built a house for himself in Madras, stayed in it until 4-4-1973 when returned back to Afghanistan. Except for the period from 5-4-1973 to 31-3-1974 during which it was let out on rent, the house remained in his possession. Mr. A returned to India on 14th July 1975 to

attend marriage of his friend at Bangalore and left India on 10th August 1975. He came to India again on 17th October, 1976 and stayed on till 1st August, 1977 when he returned back to Afghanistan. Thereafter, he came to Delhi every year to attend a religious function from 15th December to 14th January. He finally came to Madras on 18th March, 1982 and permanently settled down there. Determine his residential status for the assessment year 1983-84 (Section 6).

10. Mr. Mayers, a resident of Berlin, set up an office at Delhi for exporting steel sheets to Germany and appointed his brother-in-law as the manager. The manager bought scrap steel and established a factory for melting it and rolling it into steel sheets During the year ended 31-3-1982 steel of the value of Rs. 10 lakhs was exported to Germany. On these exports Mr. Mayers earned a profit of Rs. 1 lakh after deducting out of the invoice value of the exports the cost of scrap steel and manufacturing expenses including the manager's salary. Consider whether Mr. Mayers would be liable to pay income-tax on the profits earned by him on the export of steel sheets assuming that the total period of his stay in India during the relevant previous year was only 45 days. Would the position have been different if : (i) Mr. Mayers had bought steel scrap in India and had exported it to Germany without processing it ; or (ii) the scrap was processed by a Steel Mill in India for a fixed charge paid by Mr. Mayers [Section 9].

11. A firm registered in East Africa consisted of five partners. All of them resided in Tamil Nadu. The firm owned a textile factory in Kenya which was run by its General Manager Mr. Raghavan, a chartered accountant. At the end of each month, Mr. Raghvan submitted statements of accounts as well as statistics as regards production, sales and other activities. These were considered by the partners and necessary instructions were issued to the General Manager. Would the partners of the firm be liable to pay any income-tax on the profits arising to them in East Africa even though no part thereof was remitted to India ? (Section 7).

12. N, an owner of land in village in India used for agricultural purposes and assessed to land revenue, and of the value Rs. 2 crores, sold the same in 1980 to R for the following consideration :—

(i) Payment by R to N's debtors of the debts owned by N to the extent of Rs. 10 lakhs ;

(ii) Payment by R to N of a sum of Rs. 14,50,000 to enable the latter t meet certain personal expenses ; and

(iii) A covenant to pay to N a sum of Rs. 2,40,000 annually so long as he remained alive

N contends that there is no taxable element in those considerations as these were capital receipts or, alternatively, as these constituted agricultural income. Discuss [Sections 2, 4 and 45].

Krishna Dec. 83, 5,000 (Revised)

F. II. 38

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL

F.S.P. (I) Tax–2

FINAL COURSE

INCOME-TAX

STUDY PAPER – II

Computation of Income under Various Heads

Contents :

1. *Heads of income chargeable to Income-tax (Section 14).*
2. *Income from salaries (Sections 15 to 17).*
3. *Income from interest on securities (Sections 18 to 21).*
4. *Income from house property (Sections 22 to 27).*

1. HEADS OF INCOME (Section 14)

The gross total income of an assessee, chargeable to income-tax, must be computed under the heads specified in Section 14 of the Act. These are (1) Salaries; (2) Interest on securities ; (3) Income from house property ; (4) Profits and gains of business or profession ; (5) Capital gains; and (6) Income from other sources.

This Section only classifies the total income the scope of which is determined by Section 5 and the quantum of which is determined under the different heads of income enumerated above. Income-tax chargeable under Section 4 is only one tax and it is wrong to say that there are as many taxes as there are heads of income or sources of income. Thus, a person would be chargeable to tax on his total income even if his income under each head of income may be well below the taxable limit. The distinction between the items of income chargeable under each head has a direct bearing in regard to the set-off of losses either in the same year or to carry forward and set-off of the same in the subsequent years. Where a particular type of income has been specifically made chargeable to tax under a distinct head of income by the Act, it is obligatory on the part of both the assessees and the department to follow the same : they have no choice or option in this regard nor can they bring to charge a certain receipt as income under a different head in lieu of or in addition to the head of income specifie for the same. Even if an assessee by mistake includes an item of income unde a wrong head the department has the obligation to charge the income onl under the head specified in the Act for that income ; nor can the departmen include it as income from other sources except when it does not fall within an of the other heads of income. Similarly, expenses, losses and deductions attr butable to income under one head can be allowed only to the extent to which th provisions applicable to that head permit and where these are not deductibl either fully or in part, under the appropriate head, they cannot be deducted fro income under any other head.

2. INCOME FROM SALARIES (Sections 15 to 17)

2 1 What constitutes income under the head 'Salaries' and who is chargea to tax in respect of that income : The term 'salaries' for income-tax purpo connotes receipts of a much wider description than what is commonly understo Every payment made by an employer to any person under his service is liable be assessed under the head "Salaries". The basis is the existence of emplo employee relationship in other words, unless the recipient is the servant of person from whom the income is received, the receipt cannot be called 'sala and, consequently, cannot be brought to tax as income from 'salary'. The na given to the receipt by the recipient or the payer is immaterial for this pur, An agent will be liable to tax in respect of his income from the principal on

the agency (other than a selling or commission agency) amounts to employment and the agent becomes the servant of the principal by virtue of the agency. But the fact that a person holds office and that he receives remuneration by virtue of that office, does not necessarily mean that the person holding the office is an employee and the person paying the remuneration is the employer. For example, a director of a company holding an office in the company, not being a servant or employee of the company, would be taxable in respect of the fees received by him under the head 'income from other sources' but not as 'salaries'. However, if the director becomes an employee of the company by virtue of the terms of his contract of service with the company, the remuneration received by him even for specific services rendered would be taxable as 'salaries'.

As the Supreme Court has explained in *Ram Prasad v. C.I.T. (1972) 86 I.T.R. 122*, "a managing director may have a dual capacity. He may both be a director as well as an employee. In the capacity of managing director he may be regarded as having not only the capacity as *person* of a director but also has the *persona* of an employee or an agent depending upon the nature of his work and the terms of his employment. Where he is so employed, the relationship between him as the managing director and the company may be similar to a person who is employed as a servant or an agent for the term 'employed' is facile enough to cover any of these relationship. The nature of employment may be determined by the articles of association of the company and/or the agreement, if any, under which a contractual relationship between the director and the company has been brought about, where under the director is constituted employee of the company, if such be the case, his remuneration will be assessable as 'salary'. In other words, whether or not a managing director is a servant of the company, apart from his being a director, can only be determined by the articles of association and the terms of his employment. If the company is itself carrying on the business and assessee *i.e.*, the managing director is employed to manage its affairs in term of its articles and he could be dismissed or his employment can be terminated by the company if his work is not satisfactory, it can hardly be said that he is not a servant of the company".

Similarly an official liquidator appointed by a Court or the Government would become an employee of the Central Government under Section 448 of the Companies Act, 1956 and consequently his remuneration would be taxable as income from 'salaries'. Likewise the remuneration paid by a company to its manager even if he was wrongly designated as a director, would be taxable as salary income irrespective of the fact that the amount is payable monthly or fixed at a certain percentage of the company's profits. (But the remuneration paid to managing agents by whatever name called and howsoever calculated must be assessed as income from business but not as salaries). The treasurer of a bank over whom the bank exercises control and supervision would be an employee even if he has full control over his staff and responsible for their act. The treasurer over whom the bank has no right of control or supervision would be said to carry on vocation having due regard to his wide powers and responsibilities. As a result, the treatment of remuneration of the treasurer of a bank would depend upon the fact whether or not the treasurer is an employee of

the bank. (It may be noted that the discussion in this study only deals with the taxability or otherwise of the remuneration and the principles of computation. The principles relating to the assessment of the remuneration as the income of the individual himself or of the H.U.F. of which he is a member are discussed in Study IV while dealing with the assessment of Hindu undivided families.)

For purposes of computing income under the head "salaries" the term 'employment' would include within its scope both full-time and part-time employments. Accordingly, the salary due to or received by an individual from his different employers must be aggregated and brought to assessment under this head.

For the purpose of determining the taxability of salary in the hands of the employee, the fact whether the expenditure represented by such salary etc., is allowed or disallowed in the assessment of the employer is not a relevant consideration.

A partner of a firm cannot have the status of an employee of the same firm. Therefore, even if he is paid a fixed remuneration every month by the firm the payment must be treated as part of the share of profits of the partner from the firm; for this purpose, the fact that the remuneration is for services rendered and is called 'salaries', is immaterial.

Since employment is different from profession, the income from employment or service cannot be treated as professional income and *vise versa*. Receipts from persons other than the employer should be assessed as income from other sources even if they are called salary, wages or remuneration irrespective of the fact whether they are paid voluntarily or under an agreement and whether with or without adequate consideration. But gratuities, bonus or other voluntary payments (other than testimonials and personal gifts paid by an employer) to his employees in consideration of services rendered by the latter must be assessed as salaries.

In particular, the following receipts, whether in cash or in kind, are specifically liable to tax as income from salaries : (i) salary ; (ii) wages; (iii) annuities; (iv) bonus; (v) pension; (vi) gratuity; (vii) fees; (viii) commission; (ix) perquisites; (x) profits in lieu of or in addition to salary or wages ; (xi) any advance paid on account of salary; (xii) the amount of the employer's contribution to a Recognised Provident Fund in excess of 10% of the employer's salary; (xiii) the amount of interest accrued on the accumulated balance of a Recognised Provident Fund standing to the credit of an employee restricted to the excess over the prescribed rate of interest: 8.25% from 27-10-1978 (9% from 1-9-81); (xiv) the amount of transferred balance in a Recognised Provident Fund, to the extent to which it is taxable.

2.2 **Advance payment and arrears of salary** : Section 15 contemplates a charge on salaries (i) which are due, whether paid or not, as well as those (ii) which are paid whether due or not, in the previous year. Thus, even advance payments of salary i.e. amounts received for service to be rendered in the future, have been specifically included in the term 'salary' and are chargeable

under this head in the financial year of their receipt. Salary is taxable at the earliest point of time, i.e., the date when the salary accrues or falls due or is received. But a loan or an advance against or otherwise salary granted to an assessee by his employer repayable by deduction from salary otherwise cannot be treated as advance salary. However, to avoid double taxation of the same amount, the Explanation to Section 15 provides that the amount which has already been included in the total income of the recipient in any year as advance salary in the year of a payment shall not again be included in the total income when the salary actually falls due. But if an amount of advance salary has not been subjected to tax for some reason or other, it would become taxable in the year in which it falls due to the employee.

2.3 **Previous Year in respect of salary** : As noted earlier under Section 3 (1) (a), the term 'previous year' means the financial year immediately preceding the assessment year. If the accounts of the assessee have been made upto date within the said financial year, then Section 3 (1) (b) given an option to the assessee to have the twelve months ending on such date as the previous year. The decision of the Andhra Pradesh High Court in *Addl, C.I.T. v. K. Ramachandra Rao (1980) 4 Taxman 281* points out that the option made in Section 3 (1) (b) is available with reference to *salary income also*. Consequently, even though normally the financial year preceding the assessment year could be taken as the 'previous year' in relation to salaries, if an assessee maintains accounts in respect of salary income and if such accounts are made upto date within the said financial year, then the assessee could claim that the twelve months ending on such date be taken as the previous year. Such an option could be exercised in relation to any source of employment.

It is immaterial whether the amount is due or received from the present employer or a former employer. Where due to any reason either because the amount of salary has been revised with retrospective effect or whether the quantum of salary or bonus is determined subsequently or otherwise and the salary or bonus of several past years is received in one year, the entire amount is assessable in the year of receipt. This amount could not have been assessed in the earlier year as the same had not been ascertained or had not become due. Inclusion of the salary of more than one year in the assessment of one year may lead to a higher rate of tax being levied on the total amount. In such cases, relief in the rate of taxation would be granted to the assessee under Section 89 (1) read with Rule 21 A of the Income-tax Rules. 1962.

A lump sum paid to an employee by his employer in commutation, reduction or substitution of his salary, pension or other type of income from employment, is nonetheless, taxable as income from salary in the year of its receipt or year in which it falls due to the assessee, whichever, is earlier. However, the amount of compensation, if any, due to or received by an employee is exempt from tax under Section 10 (10B) to the extent specified as already explained in Study 1. Similarly the amount received on encashment of leave at the time of retirement or superannuation or otherwise is also exempt under the provisions of Section 10(10AA) inserted by the Finance Act, 1982, with retrospection even from the assessment year 1978-79 to the extent specified therein.

Repayments under the Additional Emolument (Compulsory Deposit) Act, 1974 would also form part of salary.

Payment of tax-free remuneration by any company to its employees is prohibited under Section 200 of the Companies Act, 1956. However, certain exceptions to this rule have been provided under this Act in case of payment of tax-free remuneration to foreign technicians and teachers under certain circumstances (as stated earlier in Study Paper I). Except in these two cases where salary is paid tax free, the employee has to include in his total income gross amount of salary i.e., the aggregate of the net salary received plus the amount of tax paid on his behalf by the employer. This provision would apply even in cases where the payment of tax by the employer on the employee's salary is undertaken voluntarily or under a contractual obligation. Tax deducted at source, provident fund contributions of the employee or other deductions made from the total salary of the employee should be added up to his net salary for ascertaining the grross amount of salary taxable in the hands of the employee. This is based on the priniciples that (i) sums paid by the employer to satisfy the debt which the employment owes to the Revenue would remain a part of the income derived from employment taxable as salaries, and (ii) the deductions are merely a means of application of income which is immaterial for tax purposes.

2.4 **Salary voluntarily surrendered** : Generally, salary would be taxable even if it is either foregone or voluntarily surrendered by the employee in favour of the employer or any other person. This is based on the principle that the surrender of salaries being only an application of income which is immaterial for tax purposes. However, with the enactment of the Voluntary Surrender of Salaries (Exemption from Taxation) Act in 1961, if any salary due to him is surrendered by any person for any period after 31-3-1961 to the Central Government, the amount thereof will not be included in his total income liable to income tax. This exemption is available to Government servants as well as any one who wish to surrender his salary in the public interest to the Central Government in accordance with the Rules framed under that Act.

2.5 **Perquisites to be taxed as salaries** : The term 'perquisite' means any casual emolument, fee or profit attached to an office or position, in addition to, salary or wage and has been defined by Section 17 (2). Perquisities may take a variety of forms e g extra payment whether voluntarily or stipulated for something done outside the duties of office, money allowance for clothes or other uniforms, loading allowance payment by the employer for lighting, heating and telephone charges and other outstandings in respect of the employee's residence : insurance premia paid by the employer on an endowment policy for ensuring an annuity to the employee or his retirement, lump sum bonus or a sum calculated with reference to the net profit of the company, a lump sum paid to a director in consideration of withholding his intended resignation, allowances paid to meet extra cost of living in a foreign country, allowances paid for the maintenance and education of children, payment of club fees for bills and cost of legal defence on a criminal charge etc. Thus, the term, 'perquisite' includes a number of items of benefits in addition to what the word means under the general law.

The type of benefits liable to tax as perquisites forming part of salary on which all employees are liable to pay tax are the following ; –

(i) Value of residential accommodation provided to the assessee by the employer, either rent fee or by way of any concession in the matter of rent [Clauses (i) & (ii)].

(ii) Any payment in discharge of an obligation by the employer which, but for such payment would have been payable by the employee [Clause (iv)].

(iii) Any sum paid or payable by the employer directly or indirectly for effecting an assurance on the life of the employee or for providing an annuity except when such sum is paid from a recognised provident fund or an approved superannuation fund [clause (v)].

(iv) in the case of an assessee who is (a) a director; or (b) an employee who is the beneficial owner of at least 20% of the equity shares of a company; or employee getting income from salaries (excluding non-monetary benefit) exceeding Rs. 18000, p.a. the value of any benefit or amenity granted or provided by the company free of cost at a concessional rate would also be treated as a perquisite (Clause iii)].

2.6. Valuation of perquisites and benefits in kind : Perquisites in kind as well as those in cash are chargeable in the hands of an employee. Since perquisites are given generally in kind it is essential to determine the monetary value of these benefits received in kind for determining the income of the employees from salaries. In the matter of valuation of perquisites, the basis of valuation has been prescribed in Rule 3 of Income-tax Rules, 1962.

(i) **Value of rent-free residential accommodation** : Salaried tax-payers could be classified into *three categories* for the purpose of determining the value of the perquisites by way of rent-free residential accommodation provided to them.

The first category consists of (a) person holding an office or post in connection with the affairs of the Union or of a State; and (b) officers of the government whose services have been lent to a body or undertaking under the control of the government, occupying residential accommodation which has been allotted to the body or undertaking by the government. In the case of a person falling under the aforesaid category, the value of rent-free residential accommodation, if unfurnished provided to him, will be taken to be the rent which has been or would have been determined as payable by him in accordance with the rule framed by the government for allotment of residence to its officers. If the accommodation is furnished, the value of the perquisite will be first determined as if it is unfurnished and to that value 10% of the original cost of the various items of furniture provided by the employer or, if the furniture is hired from a third party, the actual hire charges payable for the same will be added.

The second category of employees consists of: (a) persons employed by

the Reserve Bank of India ; (b) persons employed by a statutory corporation or by a company in which all the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that Bank; (c) persons employed by a body or undertaking financed wholly or mainly by the Government; and (d) officers of the Government whose services have been lent to or who are employed after retirement from government service with any company in which not less than 40% of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that Bank.

In the case of persons referred to in (a) to (d) above, the perquisite value of the *unfurnished* rent-free residential accommodation will be taken to be 10% of the salary due to the person in respect of the period during which the residential accommodation was occupied by him in the relevant previous year. If the accommodation is *furnished*, the value of the perquisite will *first* be determined on the above basis and then *increased* by an amount equal to 10% of the original cost of the furniture including refrigerators, television sets, radio, other household appliances and air-conditioning equipment provided by the employer. If the furniture is hired by the employer, the hire charges payable for the furniture will, instead, be taken into account.

Employees who do not fall in the first two categories would fall in the *third or residuary category* which mainly comprises employees in the *private sector*. In the case of these persons, the perquisite value of rent-free unfurnished accommodation will ordinarily be taken to be 10% of the salary of the employee in respect of the period during which he occupied accommodation during the relevant previous year. If the Income-tax Officer is satisfied the perquisite value of the accommodation computed on the basis exceeds that the fair rental value, the value of the perquisite will be limited to such fair rental value. However, if the fair rental value of the accommodation exceeds 20% of the employee's salary for the relevant period, the Income-tax Officer will have the discretion to increase the value of the perquisite (computed on the basis of 10% of the salary) by so much of the excess of fair rental value over 20% of the salary, as he may, having regard to the nature of the accommodation, deem fit. In the case of employees residing at Bombay, Calcutta, Delhi and Madras, only the excess over 30% of the salary will be added to the basic valuation of 10% of the salary in such cases, if the employee is provided with furnished residential accommodation the value of the perquisite will first be computed as if the accommodation were unfurnished and then increased by an amount equal to 10% of the original cost of the furniture (including television sets, radio sets, refrigerators, other household appliances and airconditioning plant and equipment) provided by the employer. If the furniture is hired by the employer the value of the perquisite will, instead, be increased by the hire charge payable by the employer.

It must be noted that for the purposes of computing the perquisite value of rent-free residential accommodation in the case of employees falling in the second and third category, the term 'salary' will include pay, allowances, bonus

or commission payable monthly or otherwise *but will not include* : (i) dearness allowance or dearness pay, unless it enters into the computation of superannuation or retirement benefits; (ii) employer's contribution to the provident fund account of the employee : (iii) allowances which are exempted from payment of tax; and (iv) any allowances in the nature of an entertainment allowance, to the extent such allowance is deductible under Section 16 (ii).

(ii) Residential accommodation given at a concessional rent : If residential accommodation is provided by the employer at concessional rent, the value of the perquisite will first be determined as if the employee has been provided with rent-free residential accommodation and the amount so computed will then be reduced by the rent payable by the employee.

Illustrations :

1. A, who is holding a responsible position in a private sector organisation in Delhi, draws a salary of Rs 24,000 p.a. He is provided with a rent-free furnished accommodation by his employer. The fair rental value of the house is Rs. 12,000 p.a. The original cost of the furniture provided in the house is Rs. 12,000. The value of the perquisite :

	Rs.
10% of the salary—	2,400
Excess of fair rental value over 30% of the salary (Rs. 12,000 - 7,200)	4,800
10% of the original cost of furniture	1,200
Value of the perquisite	8,400

2. What will be the position if A's place of work and residential accommodation are in Nagpur ?

	Rs.
10% of the salary –	2,400
Excess of fair rental value over 20% of salary (Rs. 12,000 - 4,800)	7,200
10% of the original cost of furniture	1,200
	10,800

3. What will be the position, if in the above cases, A happens to be an employee of a public sector undertaking ?

	Rs.
10% of salary	2,400
10% of the original cost of furniture	1,200
	3,600

4. Will your answer be any different if the furniture is not owned by the employer but hired by him at a monthly rent of Rs. 150 ?

In such a case, the charges Rs 1,800 p.a. will be added to the 10% of the salary as well as the excess of fair rental value over 20% or 30%, as the case may be, of the salary.

5. What will be the position if the fair rental value of the house provided to A, in illustrations. 1 and 2 is Rs. 3,840/- only ?

In such a case the fair rental value does not exceed 30% of the salary (the house being situated in Delhi) or 20% (the house being situated in Nagpur) of the salary ; only 10% of basic salary and 10% of the original cost of furniture, will be taken into account. Consequently, the value of the perquisite will be Rs. 3,600/-

In all the five cases explained above, if the house is not given to the employee totally rent-free but is given at a concessional rent, value of the perquisite representing the concession would be the difference between the value of the perquisite as determined above and the amount in respect of rent received from the employee. For instance, in illustration 5 above, if the rent received from the employee is Rs 2,400 p.a., the value of perquisite would be Rs 1,200 only, if the rent received from the employee is Rs. 3,000, the value of the perquisite would be Rs. 600 only.

Benefits/Amenities Taxable under Sec 17 (2) (iii) : In the case of other perquisites which are in the nature of a benefit or amenity granted or provided free of cost or at concessional rate, the question of charge would arise under Section 17(2) (iii) only if the recipient is either a director of a company or a person who has substantial interest in the company *or* is one, who is an employee under any employer, including a company, and whose income under the head 'Salaries', exclusive of non-monetary benefits exceeds Rs. 18,000 The different types of such benefits or amenities and their taxability are discussed below.

(i) **Value of motor car or other conveyance.** In all cases where a motor car or other conveyance has been provided by the employer to his employee, the value of the perquisite would depend upon the use of the conveyance for the personal purpose of the employee, the ownership including hiring rights of the car and the horse power of the car. The value of a motor-car provided by the employer for use by the assessee exclusively for his private or personal purposes must be taken to be the sum actually expended by the employer in the maintenance and running of the motor car during the relevant accounting year including the normal wear and tear where the motor car is owned by the employer.

The value of the motor car provided for the use of the employee partly for his personal purposes and partly for business purposes should be determined to be that part of the sum out the amount actually expended by the employer in the maintenance and running of the motor-car during the relevant accounting

year (including the normal wear and tear where the motor car is owned by the employer) which can reasonably be attributed to the user by assessee for his personal or private purposes. But, in cases where the determination of the value of the perquisite on the above basis is difficult, then the value of the perquisite may be determined as indicated below :

(a) Where the motor car is owned or hired by the employer and all the expenses of maintenance and running are met or reimbursed to the assessee by the employer, the value of the perquisite would be taken at—

(i) Rs. 300 per calendar month if the horse-power rating of the car does not exceed 16 or if the cubic capacity of the engine does not exceed 1.88 litres.

(ii) Rs. 400 per calendar month if the horse-power rating of the car exceeds 16 or if the cubic capacity of the engine exceeds 1.88 litres.

(b) Where the motor car is owned or hired by the employer but the expenses of its running and maintenance for his private or personal purposes are met by the assessee from out of his pocket, the perquisite would be valued at—

(i) Rs. 100 per calendar month if the horse-power rating of the car does not exceed 16 or if the cubic capacity of the engine does not exceed 1.88 litres.

(ii) Rs. 150 per calendar month if the horse-power rating of the car exceeds 16 or if the cubic capacity of the engine exceeds 1 88 litres.

If the employer also provides a chauffeur for running the motor-car for the employee's personal use, the value of the perquisite computed on the above basis will be increased by a sum of Rs. 150 per month.

Even in cases where no particular car is placed at the disposal of the employee but he is allowed the use of one or more cars out of a pool of motor cars owned or hired by the employer, the value of the perquisite will be computed in accordance with the above-mentioned rates as if the employee has been provided with one motor car used partly for his private or personal purposes and partly in the performance of his duties.

In cases where the assessee owns the motor car but the actual running and maintenance charges are met or reimbursed to him by the employer, the value of the perquisite must be determined as the sum actually expended by the employer which, in the opinion of the I.T.O., can reasonably be attributed to the use of the car by the assessee for his private or personal purposes.

For purposes of determining the value of the perquisite attributable to the use of a car by the employee, the use of the car for going from residence to the place of duty and back would be considered as use for personal purposes.

The value of the free use by the assessee of any other type of conveyance provided by the employer should be determined as the sum actually expended by the empolyer in the maintenance and running of the conveyance during the relevant accounting year including its normal wear and tear if the conveyance is owned by the employer which, in the opinion of the I.T.O., can reasonably be attributed to the user by the assessee for his private or personal purposes.

(ii) **Free Domestic Services**: As regards the provision of free domestic services, under Executive Instructions (No 133 dated 10 12.69) they are taxable on an ad hoc basis.

In the case of a sweeper provided by the employer, 75% of actual wages or Rs. 60 p m. whichever is less, and in the case of a watchman, 50% of actual wages or Rs 60 p m whichever is less will be taken to be the perquisite value.

As regards the gardener, the position will depend on the fact whether the employee is provided with an accommodation belonging to the employer or a rented accommodation. In the former case, the expenses on the gardener and on maintenance of the garden will be included in estimating the value of rent-free residential accommodation provided by the employer and the payment of salary to the gardener will not be treated as a perquisite in the hands of the employee in such cases.

In case the employee is provided by the employer with a rented accommodation, 50% of the actual wages paid to the gardener or Rs. 60 p.m. whichever is less, will be taken as the perquisite value.

If gardener or servant allowance is granted separately, such monetary allowance will be taxed as salary, and it will not come under Section 17 (2) (iii).

(iii) **Value of free supply of gas, electricity, water etc, to an employee**: The value of the benefit to an employee resulting from the supply of electricity, gas, water, etc., for his household consumption, either free of charge or at concessional rates, is determined as a sum equal to or the difference between the amount paid on that account by the employer to the agency supplying the gas, electrical energy or water In cases where such supply is made from sources owned by the employer (e.g. an electricity undertaking providing electricity to its employees free of cost) and it is not purchased from any outside agency, the value of the perquisite would be taken as 'nil'. Further, where the supply is consumed by the employee also for the purpose of his official duties, apart from the purpose of household consumption, the Income-tax Officer shall determine the value of the benefit to the employee to be equal to the amount paid on that account by the employer to the supplying agency or 6½% of the salary of the employee whichever is less

(iv) **Provision of free education**: Where free educational facilities are provided to any member of the household of an employee, the value of the prequisite is determined as the sum equal to the amount of the expenditure incurred by the

employer in making such a provision. Where the educational institution is maintained and run by the employer for the benefit of all of his employees as a group, the value of the perquisite to an employee is to be determined with reference to the reasonable cost to which the employee will be subjected in providing such education in a similar institution in or near the locality.

(v) Transport facilities provided by transport undertakings : The value of any benefit or amenity resulting from free transport provided by a transport undertaking engaged in the carrying of passengers or goods to any employee of the undertaking or his dependent relatives in any conveyance owned by the undertaking shall be taken as 'nil'. Accordingly, free travelling passes provided to railway employees of transport undertakings are treated as tax-free perquisites.

(vi) Value of other perquisites in kind not included in the foregoing categories : The value of any benefit or amenity not included in the preceding categories is to be determined on such basis and in such amounts as the Ineome-tax Officer considers fair and reasonable.

2 6. Deductions from income chargeable unher the head 'Salaries' (Section 16) : The following amounts shall be deducted in order to arrive at the income under the head "Salaries".

The standard deduction in respect of expenditure incidental to employment is allowed at an uniform rate of 20% of such salary subject to a maximum of Rs. 5,000. For this purpose, the term 'salary' will include fees, commission, perquisites or profits in lieu of or in addition to salary, but will not include payments received by the employee which are specifically exempt from tax under sub-section (10), (10A), (10B), (11), (12) and (13A) of Section 10. It may be recalled that these clauses confer exemptions respectively on gratuity, payment in commutation of pension, compensation for loss of employment, payment from statutory and recognised provident funds and house rent allowance.

The standard deduction will, however, be limited to Rs. 1,000 only in the following cases :

(a) Where he is provided with any motor car, motor cycle or scooter or other moped by his employer (for use otherwise than wholly and exclusively in the performance of his duties) ; or

(b) Where he is allowed the use of any one or more motor cars (otherwise than wholly and exclusively in the performance of his duties) out of a pool of motor cars owned or hired by the employer.

It may be noted that the standard deduction on the above basis is to be allowed irrespective of the fact whether any expenditure incidental to employment is actually incurred by the employee or not. According to the Circular No. 131 dated 18th March, 1974, issued by the Central Board of Direct Taxes, the

use of a motor car by the employee for the purposes of going from his residence to the place where the duties of employment are to be performed or from such place back to his residence, will not be regarded as use of the motor car in the performance of his duties. Consequently in such cases, the standard deduction will be restricted to Rs. 1,000 only.

With effect from 1st April, 1981 (i.e. assessment year 1981-82), standard deduction would also be admissible to pensioners.

Amendment made by the Finance Act, 1982 : With effect from 1st April 1983, the standard deduction will be allowed at the enhanced rate of 25% subject to the existing ceiling of Rs. 5,000.

(ii) **Entertainment Allowance :** (a) In the case of a government employee any allowance in the nature of an entertainment allowance specifically granted to the employee by the government is deductible subject to a maximum of Rs. 5,000 or 1/5th of his salary, whichever is less.

(b) In the case of any other employee who is in receipt of entertainment allowance, a deduction would be available only if he has been continuously and regularly in receipt of such entertainment allowance from his present employer from a date prior to 1.4.1955. The amount of deduction is : (i) the amount actually received as entertainment allowance, or (ii) the amount so received prior to 1-4-1955, or (iii) Rs 7,500 or (iv) 1/5th of the salary of the employee (exclusive of any allowance, benefit or other perquisite) whichever is the least.

2.7 Perquisites not forming part of salary ordinarily : (A) In addition to exemptions under Section 10 and Rule 3 under Executive Instructions (Department Circular No. 33 dated 1st August, 1955), the value of the undermentioned perquisites is excluded from the income of the employee.

(i) Provision of ordinary medical facilities to the employee or the dependent members of his family free of charge or the reimbursement of such medical expenses.

(ii) Provision of free refreshments, if any (but not lunch), during office hours to the employees in the office premises and at the expense of the employer. If the employer provides lunch at subsidised rates to the employees, that concession does not amount to a prequisite, but this facility must be extended to all employees of the concern.

(iii) Provision of recreational facilities for a group of employees by the employer.

(iv) Provision of transportation to the employees as a group and not to any individual employee, from their place of residence to the office and back.

It may be noted that the above perquisites are not exempted in the case

of persons covered by Section 17 (2) (iii), viz (a) Director in a Company (b) persons having substantial interest in a Company (c) Any other person drawing a salary of Rs. 18,000 or more per annum.

Certain receipts on account of salaries, perquisites or benefits have also been exempted completely from tax, and do not form a part of the total income. These exemptions are given subject to the provisions contained in Section 10 and the conditions stated therein for each item of income. These are :

(B) (a) Travel concessions to an employee being Indian citizen and his family members' dependent on him for proceeding on leave or retirement or termination of service to home districts up to 31-3-1971 and to any place within India after 1-4-1971 (Section 10 (5).

(b) Receipts by assessees who are not citizens of India by way of :

(i) Travel concessions for proceeding to home country on leave, after retirement from or termination of service and for the children of the employee studying abroad to come to India on vacation ;

(ii) Salaries paid to employees of foreign governments.

(iii) Salaries paid to employees of foreign enterprises ;

(iv) Salaries of technicians ;

(v) Salaries of employees working on foreign ships ;

(vi) Salaries of foreign professors or teachers ;

(vii) Payments to research workers ;

(viii) Salaries of foreign social workers for philanthropic purposes ;

(ix) Remuneration received by employees of foreign governments.

Some of the exemptions stated above are subject to the prior approval of the Government and in certain cases subject to the payment of tax by the employer under Section 10 (6). For details please refer to Study Paper 1.

(c) Allowances and perquisites to Indian Citizens being employees of the Government of India for services outside India [Section 10 (7)].

(d) Remuneration of foreign employees under the co-operative technical assistance programmes [Section 10 (8)]

(e) Death-cum-retirement gratuities [Section 10 (10)]

(f) Amount received in commutation of pension [Section 10 (10A)].

(g) Compensation for loss of employment [Section 10 (10B)].

(h) Payments received from a provident fund to which the Provident Fund Act, 1925, applies [Section 10 (11)].

(i) Accrued balance of a recognised provident fund [Section 10 (12)].

(j) Payments received from an approved superannuation fund [Section 10 (13)].

(k) House rent allowance received from the employer [Section 10 (13A)].

(l) Any other specific allowance (not being entertainment allowance or city compensatory allowance for performance of duties [Section 10 (14)].

(m) Daily allowance or any other allowances of the Members of Parliament and Legislative Assemblies [Section 10 (17)].

(C) The value of any gift which an employee might receive from his employer on account of the personal regard which the employer has for the employee. The essence of such a receipt is that the gift to the employee should have been made on account of pure personal feelings and regard. If it arises in any way from the recognition of the services rendered or is given in consideration of employment, it is liable to be treated as a taxable requisite. The examples of tax-free receipts of this nature would be birthday gifts to children, or wedding gifts [*Mahesh Anant Rai Pattani vs C I T. (1961) 41 I.T.R. 481 (S.C.)*] An exception to the rule is a receipt by an employee or his heirs as compensation for death or permanent disablement. It would be regarded as a capital receipt not chargeable to tax.

2.8 Profit in lieu of salary : Under Section 17 (3), the amount of any compensation received by an employee from his employer in connection with the terminattion of his employment or modification of the terms and conditions relating thereto is regarded as income chargeable to tax under the head 'Salaries'. The compensation is exempt from tax in those cases and circumstances specified in Section 10 (10B). Similarly, any other payment received by an employee from his present or past employer or from an unrecognised provident fund, to the extent to which it does not consist of his own contributions, is regarded as his income. Of course, in both these cases, if a higher rate of tax is attracted in the year in which such amount or payment is assessed, the Income tax Officer is authorised to grant relief to the tax-payer under Section 89 (1) of the Act on the lines provided in Rule 21 A of the Income-tax Rules.

In cases where the remuneration for services takes the form of a payment at the end-of period of employment, the payment does not cease to be remuneration for services rendered merely because it is payable to the employee or his legal representatives after the services have come to an end. Similarly, a sum payable to a director-employee, at the expiry of the term of his directorship or a payment made to any other employee after his termination of service would be taxable as profit in lieu of salary. This would apply even to cases where a lump sum remuneration is paid at the beginning of employment for a period of a number of years. In all such cases, it is the income of the year in which the amount is due or paid to the assessee and should not be distributed over the whole term of services. The contributions of the employer in excess of the prescribed limit *i.e*, 10% of the employee's salary and interest credited in excess of 8½ per cent *p.a.* on the balance standing to the credit of the employee would be taxable as income from salaries irrespective of the fact whether the payment

is made during or at the termination of employment. Amount received by an assessee in commutation of pension (whether in lump sum or in instalments) gratuity, compensation for retrenchment and payments from provident funds which are in excess of the limits of exemption specified in Section 10 are thus taxable as profits in lieu of or in addition to salary.

2.9 Provident Funds : For purposes of income-tax, provident funds are of four kinds, *viz* :

(a) *Statutory Provident Funds* : Provident funds which are set up under the Provident Funds Act, 1925 are called statutory provident funds. Provident funds of institutions like universities, colleges and similar educational institutions, courts, local authorities, the Government of India and State Governments would fall within the category statutory provident funds.

(b) *Recognised Provident Funds* : Provident funds which are recognised at the time of their setting up or subsequently and which continue to be recognised by the Commissioner of Income-tax under Rule 3 of Part A of the Fourth Schedule to the Income-tax Act, 1961 and provident funds established under a Scheme framed under the Employees' Provident Funds Act, 1952 are known as recognised provident funds. Provident funds of many public sector undertakings, semi-government organisations and other institutions or oganisations which are recognised by the Commissioner for income-tax purposes, would come under this category.

(c) *Unrecognised Provident Funds* : A provident fund which is not either statutory or recognised, as stated above, would be an unrecognised provident fund for income-tax purposes.

(d) *Public Provident Funds* : The provident fund set up by the Central Government in exercise of the powers conferred on it by Section 3 of the Public Provident Fund Act, 1968 under the Public Provident Fund Scheme, 1968 with effect from 1-7-1968 is called the Public Provident Fund. The Public Provident Fund Scheme is discussed later in the Study Paper VII.

Treatment of contributions and payments from provident funds

(i) In the case of a statutory provident fund the entire amount (if any) of the employer's contribution, without any limit, and interest shall not be includible in the total income of the employee both during the time of contribution and at the time of payment on retirement or otherwise. The full amount of the employee's own contribution without any limits shall rank as the qualifying amount for deduction from gross total income under Section 80 C, the provisions of which are discussed in Study Paper IV. The amount of the contribution, however, is includible in the employee's salary for ascertaining the gross total income.

(ii) In the case of a recognised provident fund, the employer's contribution in excess of 10% of the salary of the employee is to be treated as the latter's income from salaries for the year in which the contributions were made.

But the employer's contribution upto 10% of the basic pay of the employee is not to be included in the taxable income for tax purposes. As regards interest credited. only the excess amount of interest over the prescribed rate i.e., 9% with effect from 1-9-1981 p.a. is includible in the total income. The employee's contribution will be included in the total income for ascertaining the gross total income of the assessee but will qualify for deduction under Section 80C. The amount qualifying for deduction would be : (i) the sum actually contributed; or (ii) 1/5th of the employee's salary, or (iii) Rs. 10,000 whichever is the least. Thus, even if the employer's contribution is in excess of 10% of the salary and the employee's contribution is of an equal amount, the entire amount of the employee's contribution will qualify for deduction subject, however, to the overall limits.

(iii) In the case of an unrecognised provident fund the assessee's contribution would be included in his total income in full and no part thereof and the interest thereon would rank for any deduction. The entire amount of the employer's and the employee's contributions shall be ignored during the period of service. But the entire amount of the employer's contribution and interest thereon shall be taxable as the salary income of the year in which the amount is paid to the employee. The interest on the employee's own contributions to the unrecognised provident fund must be taxed as income from other sources (but not as salary income) as and when the interest becomes due. Where a provident fund is recognised for the first time, the existing balance to the credit of an employee on such date of recognition which is carried into the recognised provident fund is called the 'transfered balance'. The sums comprised in such balance shall be exempt to the extent then.

2.10 Approved Superannuation and Gratuity Funds : A superannuation fund which has been and continues to be approved by the Commissioner of Income-tax under Rule 2 of Part B of the Fourth Schedule to the Act is known as an approved superannuation fund for income-tax purposes. A superannuation fund which is not recognised or which does not continue to be so recognised would be an unapproved superannuation fund. Contribution made by the employer to a superannuation fund, whether approved or not, does not affect the assessment of the employee except at the time of payment. But contributions made by the employee to an approved superannuation fund rank for deduction along with provident fund contributions, insurance premia, etc. No limit has been prescribed in this regard as in the case of a recognised provident fund. Payment by way of pension or annuity after superannuation are taxable as salary income irrespective of the fact whether they are paid out of an approved superannuation fund or an unapproved superannuation fund. But other payments from an approved superannuation fund which in excess of the amount exempt under Section 10 (13) are chargeable to tax as profit in lieu of salary in the year in which such payment falls due to, or are received by the employee.

An approved gratuity fund is one which is approved by the Commissioner of Income-tax under Rule 2 of Part C of the Fourth Schedule to the Act. The employee is not normally required to make any contributions to the fund. So the

question of granting relief or deduction and the limits in respect thereof does not arise. But payments received by the employee from a gratuity fund whether approved or unapproved which are in excess of the amount exempt under Section 10 (10) would be includible in the total income of the employee and taxable as the income for the year in which the amount is due to or received by him.

2.11 Deduction of tax from salaries : Under the provisions of Section 192 of the Act any person responsible for paying any income chargeable under the head "salaries" to any person is bound, at the time of payment, to deduct income-tax on the amount chargeable at the rates applicable to the estimated total income of the assessee under this head in the financial year in which the salary is paid. Accordingly, a provision has also been made under Section 205 of the Act that where tax is deductible at source under Section 192, the assessee shall not be called upon to pay the tax himself to which it has been deducted from that income.

Assessment in the hands of other persons in eertain cases : Salary received by employees who are members of Hindu undivided families, may in certain cases be assessable as the income of the family. For details refer to Study Paper IV under the head 'Assessment of Hindu Undivided Families.' In the cases and circumstances falling under Section 64 (1) (ii), the remuneration of the spouse of an individual for the services rendered by him/her would be includible in the total income of the individual. For details refer to Study Paper I under the head 'Aggregation of Income'.

3. INTEREST ON SECURITIES (Sections 18 to 21)

3.1 General : Under this head tax is primarily chargeable on the amount of interest on 'securities' specified in Section 18 (1) but not that received on securities issued by a foreign government or that received on a fixed deposit account or any other account. Interest received in the last mentioned case is charged either under the head 'income from business' (Section 28) or 'income from other sources' (Section 56). Interest on 'Securities' must be brought to charge under this head even when the securities are held as a business asset or dealt with as a stock-in-trade' as in the case of a bank. The term 'Securities' as used in this Section means securities issued by . (i) the Central Government, (ii) a State Government, (iii) a local authority, (iv) a company or (v) a statutory corporation. Thus, debentures or other securities for money issued by a company would fall within this Section.

'Interest on Securities' shall be assessed as the income of the previous year in which it had accrued and fallen due for payment or that in which it has been received if it was not assessed at the time it had become due. Such a provision in certain cases might cause some hardship, in as much as that by the inclusion of the amount of interest both on accrual and on receipt basis an assessee may be called upon to pay tax on a higher slab of income in the same year. To mitigate such a hardship, a provision has been made under Section 89 (2) for relief to be granted

by the Income-tax Officer on an application being made by the assessee in accor ance with Rule 21B of the Income-tax Rules would have been tax free had the pı vident fund been a recognised one since inception.

Interest on securities must be wholly regarded as the income of the pers who is the legal owner of the securities at the time when the interest falls due f payment irrespective of the fact whether or not that person was the owner throu out the period for which the interest is paid. This provision would apply even cases where the interest falls due after the death of the owner. In otherwords, part of the interest, apportioned to the person up to death, should not be treat as the income of the deceased.

In case where the securities giving rise to the interest income represent asset transferred by the assessee to any person without adequate consideratic and the provisions of Section 64 apply, the interest income will be first comput under this head and then included in the total income of the transferor as h income from other sources for purposes of assessment.

If an assessee, who is a dealer in securities, has brought forward loss computed under the head 'Profits and gains of business or profession', these loss could be set off against the current year's income by way of interest on securiti which are held as stock-in-trade of the assessee subject, however, to the conditioı that (i) the time limit of eight years had not elapsed; and (ii) the busine in which the loss was incurred is continued to be carried on by the same assesse This principle has been laid down by the Supreme Court in *C.I.T. v. Coconac Radhaswami Bank (1965) 57 I.T.R. 306.*

For the purpose of computing the income under this head, interest shoul not be deemed to have accrued from day to day but on certain fixed dates c which it fall due for payment. When securities have been purchased at a pri expressed as a capital sum *plus* interest computed from day to day from the la date of payment of interest to the date of sale, the purchaser is assessable on th whole amount interest received by him on the next due date and he is nc entitled to any deduction in respect of the interest paid by him to the vendo For the same reason, the seller of securities-cum-interest is not assessable on th amount he receives in respect of interest from the purchaser. This rule mus however, be read subject to the provisions of Section 94 which hits at those wh seek to avoid tax by systematic sale of securities-cum-interest. Under th Section, the Income-tax Officer my, in certain circumstance, deem the intere on securities to accrue from day to day and tax the seller on that basis

3.2 Deduction (Sections 19 and 20).

(a) In the case of assessees other than banks (Section (19) :

(*i*) *Collection charges* : The assessee is entitled to an allowance by way o deduction in respect of any sum rasonable expended by him for the purpose o realising the interest on securities (e.g., bank charges for collection). **But a**

assessee who collects the interest himself cannot charge a fee for his efforts and claim it as deduction under Section 19 (1)

(*ii*) *Interest on borrowings* : The amount of interest payable by the assessee (whether actually paid by him or not) on the moneys borrowed for the purpose of investment in the securities is allowable as a deduction. In order to claim this deduction, the money must have been borrowed by the assessee solely and specifically for the purpose of investment in the securities and not for any other purpose. This deduction is permissible without any condition or exception provided that the interest on the borrowing is payable in India, whether taxable or not. The deduction is available even if (i) the interest on borrowed moneys is payable at a rate higher than the rate of interest on securities, or (ii) the securities have yielded less or no income during the relevant previous year

Where the total amount of deduction exceeds the income from securities the resultant loss can be set off against the assessee's income under any other head in the same year; but such a loss cannot be carried forward. Where the interest on any security is exempt from tax by virtue of its tax-free issue by the Central or State Government, the assessee cannot claim any deduction in respect of the interest on money borrowed for investment in the tax-free securities.

(b) In the case of a banking company (Section 20) :

(*i*) *Collection charges* : The amount deductible in this regard shall be calculated as under.

$$\frac{\text{Expenses of the bank} \times \text{Interest on securities (gross)}}{\text{Gross receipts of the bank from all sources}}$$

The expenses to be taken into account for this purpose are those covered by Sections 30, 31, 36 (other than the ones enumerated in Section 36 (1) (i), (ii), (vi) and (vii) and 37). (In other words, expenses by way of rent, rates, taxes, repair and insurance for the building, plant, machinery and funiture, premium on the insurance of stocks or stores, bonus or commission to employees, contribution to a statutory or recognised provident fund or an approved superannuation fund or an approved gratuity fund, special reserve by a financial corporation (subject to the limits), expenses on family planning and other revenue expenses wholly and exclusively incurred for the purpose of the business, shall rank for deduction in this regard. Thus, in the case of a banking company a part of the overhead and running expenses which would normally be allowable as business expenditure is allowable as deduction by way of collection charges.)

(*ii*) *Interest on moneys borrowed* : In the case of banks, moneys borrowed would also include moneys received by way of deposits of all types. The deductions in respect of interest on borrowings will have to be calculated by applying the following formula :

$$\frac{\text{Interest payable on borrowings and deposits} \times \text{Interest on securities (gross)}}{\text{Gross receipt of the bank from all sources}}$$

In calculating the proportionate amount of deduction only the interest on securities which are taxable (but not those which are exempt) shall be taken into

account. The entire amount of interest paid by the bank on its borrowings and deposits received in the normal course of its business should, therefore, be allowed as a deduction between the two heads of its income *viz.* interest on securities and income from business irrespective of the fact whether the bank has purchased taxable or tax free or exempted securities in the normal course of its business.

It has been specifically provided that a part of the amount claimed as deduction by a bank from its income from securities shall not again form part of the deductions allowable to the bank in computing its business income.

3.3 **Amount not deductible** (Section 21) : This Section provides that if interest is payable outside India and is chargeable under the Income-tax Act in the hands of the lenders, e.g., under Section 9 (1) (i) . it is not a permissible deduction in the assessment of the payer from his income chargeable to tax under *any head except* in cases where (i) the interest is on a loan issued for public subscription before Ist April, 1938 or (ii) tax has been paid or deducted at source in respect of such interest: or (iii) there is a person in India who may be charged to tax as an agent under Section 163 in respect of such interest.

These restrictions on the deduction of interest payable to a lender outside India and chargeable under this Act have been inserted to counter act evasion of tax payable by the lender in respect of the interest that he receives.

3.4 **Deduction of tax at source** : Under Section 193 of the Act, any person responsible for paying 'Interest on Securities' chargeable ro tax under this head must, at the time of payment, deduct income-tax at the rates prescribed by the Finance Act in force on the amount of interest payable. The provisions in this regard and the exemptions are discussed in Study Paper VII under the head 'Deduction of tax at source'.

Rates of deduction of tax at source from interest on securities : The rates for deduction of tax from interest on securities as prescribed in Part II of the First Schedule to the Finance Act, 1982 are :

	Rate of Income-tax	*Rate of surcharge*	*Total*
In the case of a person (*i.e.*, the recipient) other than a company –			
(a) Where the recipient is a resident in India on interest on securities whieh are taxable	20%	2%	22%
(b) Where the recipient is not a resident in India			
(i) on interest on securities which are taxable	30%	3%	33%
	Or the income-tax plus surcharge calculated on the income, whichever is higher.		
(ii) on interest on tax-free securities	15%	1.5%	16.5%

2. In the case of a company —	Rate of income-tax	Rate of surcharge	Total
(a) Where the company is a domestic company, on the interest on securities (other than tax-free securities)	21.5%	0.5%	22%
(b) Where the company is not a domestic company :			
(i) on its income from interest on tax-free securities,	44%	1.1%	45.1%
(ii) on its income from interest on taxable securities	70%	1.75%	71.75%

3.5 **Tax Concessions :** *Total Exemptions* : In the following cases income arising from securities issued by or on behalf of the Central Government are not to be included in the total income and hence are totally exempt from tax :

(a) The Government may declare, by notification in the Official Gazette, certain specific securities as tax-free for non-residents. Any income from interest on such securities arising only to non-residents shall be totally exempt from tax [Section 10 (4)].

(b) Interest received from the following investments issued by or on behalf of the Government are totally exempted from tax ; (i) Monthly payment on the 15-Year Annuity Certificates; (ii) Interest on Treasury Deposit Certificates; (iii) Interest on income arising from all postal deposits and investments up to the limits prescribed under the Postal Rules Section 10 (15)].

(c) Income under the head 'Interest on Securities' arising to (i) a sports association; (ii) an authority constituted for housing; (iii) a hospital or other institution; (iv) a registered trade union; (v) the trustees of a recognised provident fund, (vi) a provident fund set up under the Provident Funds Act, 1925; (vii) the trustees of an approved superannuation funds; (viii) the trustees of an approved gratuity fund; (ix) the members of Scheduled Tribes as mentioned in the Constitution of India; (x) a local authority; (xi) a scientific research association; and (xii) a University or other educational institution.

Interest received on securities issued tax-free by the Central or a State Government is to be included in the total income of the assessee for the purposes and a rebate is allowed thereon at an average rate or at the rate of 27½% whichever is less.

Lower Rate of Tax (Section 112 A): Income from interest on National Savings Certificate (First Issue) including Bank Series, enjoys a tax concession. The tax on such interest is payable at the rate applicable to the total income

excluding this interest. Thus, if an assessee earns ***Rs. 16,000*** *out of which R 1,000 is the income from N.S.C (Ist Issue) tax will be* ***calculated*** *on Rs. 15,00 and an average rate arrived at. This rate will be applied to* ***Rs. 16,000*** *and tax charged thereon.*

4. INCOME FROM HOUSE PROPERTY (Sections 22 to 27)

4.1 General Principles (Sections 22, 26 & 27) *: Tax is payable under the head* 'income from house property' in respect of the annual value of the property consisting of any buildings or lands appurtenant thereto, of which the assessee is the legal or beneficial owner but not a mere tenant or occupant. Income from house properties used for purposes of any business or profession carried on by the assessee, including staff quarters given on rent, are not included under this head of income but would be assessed as business income. Income from house property situated abroad is also assessable under Section 22 even though the property may have been acquired in the normal course of the business. Income derived from vacant plots of land on which no building has been constructed is not chargeable under this head but as income from business if the landed property is held or acquired in the course of business and as income from other sources in all other cases. Even if the house property is held as stock in trade of a business, the income from such property would be assessable under this head but not as business income.

The subject of charge in this case is the annual value of the property. In other words, tax is levied not upon the actual income from the property but upon the notional income represented by the annual value. This tax is charged on the artificial income even if, in fact, the owner receives no income whatsoever or even if there is no possibility of his receiving any income from the property. Accordingly, the trustees of a trust would be taxable on the annual value of the trust property even though, under the will or trust deed, the property could not be let out to any one but had to be given free of rent to certain beneficiaries for charitable or religious purposes. The liability to tax is not dependent on the ability of the owner to let out the property or his capacity to receive *bonafide* annual value of the property. It springs from the fact that the assessee is the legal, beneficial or deemed owner of the property.

The tax chargeable in respect of the property is based upon the ownership and not the mere occupation or possession thereof. Ownership, for this purpose, means the ownership of the property but not ownership of the annual value. The Supreme Court has held in *Jodha Mal Kuthiala V. C I.T. 82 I.T.R. 570,* that an owner means a person who can exercise the rights of an owner and is entitled to the income from the property. The court held that the assessment should be made not on the person who has the bare husk of the legal title but on the person who has the beneficial ownership of the property in a practical sense. Where the property is held in trust, the assessment under Section 22 may be made either on the trustees or on the beneficiaries. Similarly, if the owner of the property becomes insolvent, the official assignee or receiver under the law of insolvency would be chargeable in respect of the income from such house property as the owner. But where the receiver is appointed by a Court, the property does not

vest in him and, consequently, he would not be liable to tax in respect thereof as the owner. If the property is mortgaged, it is the mortgager (and not the mortgagee) who would be taxable as the owner and for this purpose the nature or purpose of the mortgage is immaterial Where the property is owned by a partnership firm it is the firm and not the partners who would be chargeable to tax under this Section irrespective of the fact whether it is registered, unregistered or treated as registered.

In cases where an assessee takes property on lease, sets up a market thereon and lets out the shops and stalls in the market, these activities of the assessee would constitute 'business', as defined in Section 2(13), and the income derived by him from subletting the stalls would consequently be taxable as income from business but not as income from house property or as income from other sources. This is because of the fact that the liability to tax under Section 22 of the Income tax Act is only on the owner (but not on the lessee) of the buildings or lands appurtenant thereto. In cases where the assessee is the owner of the buildings or lands appurtenant thereto, he would be liable to pay tax under this Section even if the object of the assessee in purchasing the landed property is to promote and develop a market thereon. It would also make no difference if the assessee is a company incorporated with the object of buying and developing landed properties and promoting and setting up markets thereon. [*83 I T.R. 700* (*S.C.*)]

The owner of a building must be assessed in respect of the income therefrom even if he is not owner but a long-term lessee of the land of which the building is constructed because the person who builds a superstructure on a plot of land belonging to another would constitute the owner of the superstructure during the currency of the lease. On expiry of the lease the owner of the superstructure would cease to be the owner of the buildings if the terms of the lease deed provide that the building should belong to the lessor. But in the case of a short-term lease of a building, the lease is not assessable as the owner under this Section and, consequently, any income derived by him from subletting or reletting the building or from assignment of the lease must be assessed as "income from other sources." The fact that the owner is under certain restrictions in regard to the transfer or disposition of the property does not in any way affect his liability to tax. The question of ownership in all cases has to be determined with reference to the accounting years and not the assessment year. The owner would be assessable even if he was not the owner of the property in the earlier year or had ceased to be the owner in the subsequent year. In case of dispute as to the title to the property, the Income-tax Officer has to decide whether the assessee is *prima facie* the owner of the property without considering the fact that there is a dispute as to title and a suit has been filed in a court or without waiting for the decision of the court in respect of the title of the property. However, where the court's final decision is contrary to the Income-tax Officer's, the latter shall reopen the assessment to make such changes may be necessary.

Where a property is owned jointly by two of more persons, and their respective shares are defined and ascertainable, the co-owners are to be assessed individually on their share in the income from the property; they should not be assessed as an association of persons (Section 26). In cases where the house

property is owned by co-owners, for computing the share of each co-owner, the determination of the co-owner's entitlement in respect of the property must be made as if each of the co owners is individually entitled to the concessional treatment sought to be provided by Section 23 (2). Thus, in a case where two persons are entitled jointly to own one residential house, the share of each co-owner shall be ascertained and each one of them will be entitled to the benefit of deduction of a sum equal to Rs 1,800 (w e f, Ass year 1983-84 – Rs 3600) or 50% of the adjusted annual rental value and then restricting the adjusted rental value to 10% of the gross total income of each one of them for purposes of assessment This is made clear in the Explanation to Section 26 of the Act.

Where the property is owned by a Tenants' Ownership Co-operative Housing Society or Tenants' Co-partnership Housing Society, every member is deemed to be the owner of the portion of the property allotted or leased to him and is assessable individually in respect of its income computed in the usual manner for the property under this occupation (Section 27 (iii). Where the property is transferred by any person to his/her spouse or a minor child (not being a married daughter) otherwise than for adequate consideration (except when the transfer in the case of wife or husband is in connection with an agreement to live apart) the transferor is treated as the owner of the property and is liable to tax on the income from house property Section 27 (i), The holder of an impartible estate shall be deemed to be the individual owner of all the properties in the estate [Section 27 (ii)].

4.2 Annual Value (Section 23)—Section 23 (i) deals with the concept of 'annual value' which is the subject of charge, It represents the sum for which the property might reasonably be expected to be let out from year to year; that is to say it is the fair rent derivable from the property if it were let out, having regard to all the prevailing circumstances, such as local conditions, demand for houses in that locality, etc In cases where the property is let out and the annual rent received or receivable by the owner in respect thereof is in excess of such fair rental value, the actual amount received or receivable would constitute the annual value.

The expression "*annual rent*" means (a) in a case where the property is let throughout the previous year, the actual rent received or receivable by the owner in respect of such year; and (b) in any other case, the amount which bears the same proportion to the amount of the actual rent received or receivable by the owner for the period for which the property is let as the period of 12 months bears to such period. In other words, the annual value of the property must. in cases where the previous year is a period less or more than 12 months, be taken to be the proportionate amount of annual rental value

The previous year for house property as a source of income, commences from the date of completion of its construction and does not begin from the date of its occupancy or letting out: the date of ending of the previous year would depend upon the assessee's choice of previous year for this source Since the liability to tax is attracted by virtue of the ownership of the property, the method of accounting followed by the tax-payer is irrelevant for the assessment,

Where the property is let out, the rent receivable by the landlord may be more or less than the actual rent received. The rent received by the landlord must be taken as the sum equal to the amount he had actually received by way of rent *plus* the expenses, if any, in respect of the property which were paid by the tenant whether as a part of the rent or otherwise. If the property is let out for a certain period of years at an increasing or reducing rate of rent, the annual value may be arrived at by averaging. Where the property consists of a number of shops or residential units, the annual rental value of each shops or units will have to be ascertained separately and the aggregate amount alone would be assessable as the annual value of the same property. The annual value of the same property may vary from year to year and consequently the tax payable in respect thereof would also vary. The valuation adopted by the municipality or other local authority may also be taken *prima facie* as the annual value of the property in cases where the rent received by the landlord does not represent the correct annual value. The municipal taxes or other expenses which were adjusted against the rent by the landlord or the tenant should be added back in order to ascertain the annual value though the whole or a part of such expenses may be allowable as a deduction in computing the income from the property.

Deduction of Municipal Taxes : Both in the case of a house property which is in the occupation of a tenant, and a house occupied by the owner for purposes of his own residence, taxes levied by any municipality or other local authority in respect of the property shall, to the extent to which such taxes are borne by the owner, be deducted in determining its annual value The deduction is to be made from the annual value of the property. The deduction allowable in this regard is in respect of both municipal taxes as well as service charges levied (and not merely collected) by the local authority.

Annual value of newly constructed residential units whish are let out : The annual value of residential units which are newly constructed and let out will be reduced further by a special deduction, provided under the second proviso to Section 23 (1).

Accordingly. in respect of residential units whose construction was begun after 31-12-1961 but completed *after 31-3-1970* but before 31st March 1978 the deduction allowable shall be Rs 1,200 for each unit or the amount of annual value thereof whichever is less; and this deduction is allowable for a period of five years immediately following the date of completion of construction of the building Any residential unit which is let out by its owner being a house property the erection of which was begun after 1st April. 1961 but completed after 31st March, 1978 would entitle its owner to claim a deduction of sum equal to Rs. 2,400 or the annual value for each such residential unit, whichever is less for a total period of five years from the date of completion of erection of the house property.

As a result of the amendments made by the Finance Act, 1982, by the insertion of clause (d) in the second proviso to Section 23(1), in relation to a building comprising one or more residential units, the erection of which is completed *after 31st March, 1982*, the amount of special deduction would be Rs 3,600 or the annual value for each such residential unit, whichever is less This deduction would be available for a period of five years from the date of completion of the building.

It is significant to note that the second proviso, to Section 23(1) which provides for this special deduction ends with the words that "so however' that the income in respect of any residential unit referred to in clause (a) or clause (b) or clause (c) or clause (d) is in no case a loss" These words mean that the deduction under the second proviso cannot be allowed in such a way as to yield a loss in respect of any residential unit referred to therein In other words, it bars the allowance of the deduction under the second proviso to section 23(1)—deduction in respect of newly constructed units - in a case where the net result of the computation in respect of such property by virtue of deduction of municipal tax under the first proviso to Section 23( ) and the deductions admissible under Section 24-is already a negative figure.

It is significant to note that the Act does not bar the computation of a loss in the case of a newly constructed house property which is let out. It only bars the allowance of the said deduction in a case where the income in respect of such unit is a loss.

Another significant point that is to be noted in this context is that Explanation to Section 23 (2) makes it clear that where such a new residential unit is in the occupation of the owner for the purposes of his own residence, the special deduction envisaged in the second proviso to Section 23(1) would not be applicable in computing the annual value of such a unit.

The aggregate annual value of the units of an assessee can in no case be reduced to a loss No deduction shall, however, be allowed in respect of newly built residential units which are occupied by the owner for purposes of his own residence.

Self-occupied property : Where the house property is in the occupation of the owner who himself resides in the property, the amount of annual value is first determined on the above basis without making any allowance for newly constructed residential units. Then the amount is reduced by one-half of the annual valueor Rs 1.800, whichever is less. As a result of the amendments made by the Finance Act, 1982, with effect from 1st April 1983 (assessment year 1983-84) the monetary limit of Rs 1800 will be increased to Rs. 3600. Furthermore, the annual value so calculated must be limited to 10% of the total income of the assessee from all sources other than from the self-occupied property and before any deduction is made under Chapter VIA.

It is to be noted that, the concessional tax treatment available for computing income from self-occupied residential house limited only to one house owned by the assessee. In cases where the assessee owns more houses than one and retains all of them for his own residential purposes, the assesssee will have to specify the house in respect of which he would like to claim the concessional tax treatment.

Unoccupied residential house : Where the assessee owns only one residential house and is not in a position to occupy the same due to the requirements of his employment, business or profession at any other place and at that place he resides in a house not belonging to him, annual value of such a house would be taken

to be 'nil', if it was not occupied throughout the year and proportionately if it was occupied only for a part of the year. However, the income computed in respect of such property shall in no case be assessed as a loss. This concession is available only when the house is neither actually let out nor any other benefit is derived by the owner therefrom [Section 23 (3) and 24 (2)].

4.3 **Deductions permissible (Section 24) :** The adjusted annual value is taxable as income from house property after allowing the deductions specified in this section. This list of allowances is exhaustive. No other expenditure or loss such as licence-fees, royalties, commission or charges for registration of the building and the tenancy agreement under the Rent Control Act would be allowed as a deduction.

(a) *Repairs* ;—A fixed allowance of a sum equal to *one-sixth* of the annual value is granted where the property is either (i) in the occupation of the owner or (ii) let out to a tenant and the owner has undertaken to bear the cost of repairs. Where the tenant undertakes to bear the cost of repairs, the excess of the annual value over the rent payable for a year by the tenant is deductible subject to a ceiling of one-sixth of the annual value. The owner is entitled to the allowance in respect of repairs under this clause irrespective of any sum being actually expended for the purpose of repairs and also irrespective of any vacancies.

(b) *Insurance premia* :—The amount of any annual premium paid by the owner to insure the property against any risk of damage or destruction to it through any cause would be allowable as a deduction in full without any limits.

(c) *Interest on mortgage* :—If the property had been mortgaged solely for the purpose of raising funds and the funds have been wholly and actually utilised for acquiring, constructing, repairing or renovating the property, the interest payable on such mortgage is allowable as a deduction. If the moneys raised on mortgage are used for any other purposes, no deduction would be available in respect of the interest. If a part of the money so raised is used for the above purposes, deduction would be allowed in respect of the proportionate amount of interest.

(d) *Annual charge* : Where the property is subject to an annual charge which is created as a result of some legal obligation, the amount of such annual charge is deductible in full. In order to be entitled to this deduction, the annual charge must *not be*—(i) a charge created voluntarily by the assessee, directly or indirectly, or (ii) a capital charge. Annual charge does not, however, include any tax in respect of the property or its income levied by a local authority, or the Central or State Government. Thus, annual charge created by the assessee voluntarily out of love and affection to his relatives or other person is now not entitled for this deduction.

Capital charge and annual charge :—If a debt is charged on the property, that would be capital charge, but if the interest on the debt is charged on the property, that would be an annual charge. Annual charge involves two concepts *viz* (i) the annual liability to pay, and (ii) the creation of a charge on the house property, express or implied, for the discharge of that liability. A liability, which is in law enforceable by seizure and sale of the property, would not amount to an annual charge. Annual charge implies a liability which recurs every year. If

the charge is a capital one, only the amount of interest thereon is allowable. Annual charge or interest payable abroad is not to be allowed in the circumstances set out in Section 25.

(e) *Ground rent*:—In cases where the owner of the building is the lessee of the land on which the building is erected and as per the lease deed he has to pay to the lesser or any other person any sum by way of ground rent in respect of the lease of the site, the amount so paid or payable as ground rent would be allowable as a deduction Where the ground rent is enhanced with retrospective effect, the assessee has the right to deduction of the entire amount of ground rent payable by him in the year in which the liability arises The department cannot disallow the same on the ground that the amount relates to different years nor can it reopen the assessments of the earlier years for the purpose of allowing this enhanced deduction in those years.

(f) *Interest on borrowing*:—Interest on money borrowed for the purpose of acquiring, constructing, repairing, renewing or reconstructing the property is deductible in full from the annual value. This allowance is permissible regardless of the fact that the principal or the interest is not a charge on the property or its income or that the rate of interest is very high or that the amount was not borrowed solely for the purpose But the interest would not be deductible from the annual value in the year in which the income from the property itself is exempt from tax.

(g) *Land revenue and property tax*:—Amount actually paid by the assessee by way of land revenue [other than municipal or local taxes and land tax (e.g., urban land or immovable property tax] levied by the State Government in respect of the property will be allowed as a deduction in full even if the payment relates to earlier years.

(h) *Collection charges*:—Any sum actually spent by the assessee for collection of the rent from the property is deductible from the annual value Th amount of deduction would be the amount actually spent by the assessee for thi purpose or 6% of the annual value, whichever is less. The deduction is allowabl only in respect of income from house let out but not the one occupied by th owner for purposes of his own residence. Legal expenses incurred for recoverin rents from tenants are to be treated, under Executive Instructions, as a part collection charges.

(i) *Vacancy allowance*:—Where the property which is let out remain vacant in any previous year, a deduction of a part of the gross annual val proportionate to the period of the vacancy of the property is allowable as deduction. Where the house is occupied by the owner for purpose of his ov residence, no deduction in respect of its vacancy is allowable.

The Explanation to Section 24 (1) (ix) makes it clear that the vacancy al wance would be granted to the assessee irrespective of the fact whether the pı perty or any part thereof has remained vacant before or after the property v let out. Thus, the vacancy allowance is admissible even in cases where the p perty remains vacant before it is actually let out by the owner.

(j) *Irrecoverable rent* :—The amount of unrealised rent, where the property has been let out, is deductible in full subject, however, to the following conditions laid down in Rule 4 of the Income-tax Rules, 1962. In other words, deduction shall be allowed of such part of the income in respect of which tax is payable under this head as is equal to the amount of the rent payable, but not paid, by a tenant of the assessee and so proved to be lost and irrecoverable. The conditions subject to which the allowance is permissible are as under :

(a) The tenancy must be *bona fide.*

(b) The defaulting tenant must have vacated the house or steps must have been taken to compel him to vacate the property.

(c) The defaulting tenant should not be in the occupation of any other property of the assessee.

(d) The assessee must have taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or must satisfy the Income-tax Officer that legal proceedings, even if taken, would be useless.

(e) The annual value of the property to which the unpaid rent relates must have been included in the assessed income of the previous year during which the rent was due and tax should have been duly paid on such assessed income.

In all cases, the deduction allowable in respect of unrealised rent shall not exceed the income chargeable under the head 'Income from house property' included in the total income. as computed before making any allowance in this regard.

In view of the aforesaid condition (e), the deduction on account of unrealised rent can be claimed only with reference to the period earlier than the previous year Consequently, it may be said that the deduction during the previous year cannot relate to the unrealised rent in respect of that year. If the unrealised rent exceeds the income under the head 'income from house property', though the deduction is to be restricted to such income, set off of the excess amount can be claimed by the assessee in subsequent years till it is fully exhausted (C.I.T. v. Madho Pd. Jatia (1976) 105 I.T.R. 179 (SC).

The aggregate amount of permissible deductions in the cases of an unoccupied residential house shall not. however, exceed the annual value of the property as determined under Section 23 (3).

4 4 **Loss** : If in a certain year the aggregate amount of permissible deductions exceeds the annual value of the property, there will be a 'loss' under this head. The loss would be set off under Section 71 against income arising under other heads in the same year but the unabsorbed part of this loss cannot be carried forward However, such a loss cannot be determined or set off in cases covered by Section 23(1) Second proviso (newly built residential houses where the assessee has availed of the special deduction) and Section 23 (unoccupied residential houses) read with Section 24(2).

4.5 Amounts not deductible (Section 25) : The amount of any annual charge or interest which would otherwise be deductible from the income from house property must be disallowed if the interest or annual charge is liable to tax as income under this Act is payable outside India and (i) in respect of which tax has not been paid or deducted at source or (ii) in respect of which there is no person in India who may be treated as an agent or representative assessee under Section 163 of Act. However, this provision will not apply to any interest payable outside India on a loan issued for public subscription before 1-4-1938.

SELF-EXAMINATION QUESTIONS

These questions are intended to enable the student to test his knowledge before proceeding to answer the test paper, The answers to these questions are not intended to be written out or submitted for evaluation,

1. Income from salaries is normally charged to tax on (a) accrual basis, (b) receipt basis, (c) due basis, (d) at the discretion of the assessee, (e) at the discretion of the I.T.O. ( )

2. For purposes of taxation of salaries the previous year shall be (a) the calendar year, (b) the accounting year of the employer, (c) the accounting year of the employee, (d) the financial year or the period of twelve months for which the assessee has maintained accounts in this regard, (e) the year in which the salary income is declared in the return filed by the assessee ( )

3. Salary received in advance is taxable as the income of (a) the year in which it is received, (b the year in respect of which it is received, (c) is treated as a loan to be repaid and hence is not taxed at all. ( )

4. The cost of defending a suit incurred by an employer, on behalf of an employee even without the latter's consent is (a) taxable as business income, (b) taxable as income from other sources, (c) exempt from tax (d) treated as a perquisite and taxable as salaries (e) partly exempt and partly taxable in hands of the employee depending upon the amount that would have been spent by the employee had he defended himself.

5. The maximum amount of deduction allowable in respect of entertainment allowance in the case of Government employees is limited to – (i) (a) 1/6th (b) 1/8th, (c) 1/5th of salary or (ii) (a) Rs. 7,500, (b) Rs. 10,000, (c) Rs. 5,000, (d) Rs. 12,000, (e) Rs. 6,000 whichever is less. ( ) ( )

6. In order to be entitled for the deduction on account of entertainment allowance non-Government employees should have been receiving the allowance from their present employers from a date prior to—
(a) 1-4-1955, (b) 1-4-1961, (c) 1-4-1954. ( )

7. The amount of deduction on account of entertainment allowance permissible in the case of non-Government employees shall not exceed —
(i) (a) Rs 5,000, (b) Rs. 7,500, (c) Rs. 10,000, (d) Rs. 12,000 (e) Rs. 6,000 or (ii) (a) 1/6th, (b) 1/4th, (c) 1/8th, (d) 1/5th, (e) 1/11th of salary or (iii) the amount received prior to (a) 1-4-1955, (b) 1-4-1954, (c) 1-4-1961, (d) 1-4-1971, whichever is the least.

8. The amount of standard deduction allowable to employees not deriving any benefit towards conveyance for the assessment year 1981-82 should not exceed (a) Rs 1,000 (b) Rs. 2,500 (c) Rs 3,500 (d) Rs. 8,000.

9. In cases where an employee gets any allowance or benefit towards conveyance for his personal purposes the standard deduction for the assessment year 1982-83, will be subject to a maximum of, (a) Rs. 2,000, (b) Rs. 3,500 (c) Rs. 1,000. (d) Rs. 5,000 ( )

10. The city compensatory allowance received by employees in the public sector is (a) exempt from tax under Section 10 (14), (b) taxable as salaries, (c) includible in the total income and qualifies for deduction (d) to be ignored in computing the total income. ( )

11. The salary of a Government employee for the month of March 1980 which is paid on 1st April, 1980 is to be taxed as his income of the (a) calendar year 1980, (b) financial year 1980-81, (c) financial year 1979-80, (d) accounting year of the Government ending on 30th June. ( )

12. Personal gifts, presents and testimonials received by an employee from his employer in appreciation of his meritorious work are (a) taxable as salaries, (b) taxable as perquisites, (c) taxable as income from other sources, (d) not taxable, (e) taxable as capital gains due to appreciation of the value of his services. ( )

13. The amount of salary paid to an employee which is disallowed as a deduction while computing the taxable income of the employer is (a) totally exempt from tax, (b) includible in the total income only for rate purposes, (c) taxable in full (d) entitled to relief under Section 89 (1) in the hands of the employee. ( )

14 Interest on securities is taxable on (a) due basis, (b) accrual basis, (c) receipt basis (d) the basis of entry in the accounts of the empolyee ( )

15. Interest on securities is chargeable to tax as the income of (a) the financial year, (b) accounting year followed by the assessee, (c) assessment year, (d) calendar year. ( )

(16) The term 'securities' in relation to those issued by companies will mean (a) shares, (b) loans, (c) investments, (d) debentures and securities received for advancing loans ( )

17. Interest on securities which was not charged to tax in the year in which it was due but received in a later year is taxable (a) as the income of the financial year in which it is received, (b) as the income of the accounting year in respect of which it is received by reopening the earlier assessment, (c) as the income of the accounting year in which it was received. (d) as concealed income resulting in the levy of penalty and conviction. ( )

18. If an assessee earns interest @ 5% from the securities held by him but the interest payable by him on the moneys borrowed for purposes of investment

is at 10% the assessee would be entitled to deduction of the interest on borrowings at a rate not exceeding (a) 10%, (b) 9%, (c) 5%, (d) 6%, (e) 12%. ( )

19. The tax in respect of income from house property is upon the (a) owner (b) tenant, (c) occupant, (d) mortgagee, (e) lessee. ( )

20 The basis of charging income from property is (a) the fair rent, (b) actual rent, (c) annual value, (d) municipal value. ( )

21. The excess of actual rent over the letting value is (a) chargeable to excess profits tax, (b) taxable as business income (c) taxable as capital gains, (d) not chargeable to income-tax at all, (e) taxable as a part of annual value. ( )

22. Income from house property which is held as a business asset or stock in-trade should be assessed as (a) income from business, (b) income from house property, (c) income from other sources, (d) capital gains. ( )

23. Income from house property occupied for purposes of the assessee's business or profession is (a) taxable under Section 22, (b) taxable under Section 56, (c) taxable as business income, (d) not assessable since the building is depreciable asset. ( )

24. Since the liability to tax under Section 22 arises from the ownership of the property, if the owning of the house property is profitable, the profits arising continuously therefrom are taxable as (a) business income, (b) income from house property, (c) Income from other sources, (d) capital gains. ( )

25. Where a house property is owned by a partnership the assessment of the income from the property should be made on (a) the partners individually (b) the partners collectively as an association of persons, (c) the person from whom the firm acquired the property, (d) the firm ( )

26. The liability to tax in respect of income from house property covers the (a) income from leasehold building alone, (b) buildings' or lands appurtenant thereto, (c) lands alone., (d) superstructure on the lands represented by buildings, (e) freehold land and buildings ( )

2', Income derived from letting out an entire business asset consisting of a hotel or a jute mill should be assessed as (a) income from house property, (b) as income from pofession, (c) capital gains, (d) income from othe sources (e) income from business. ( )

28 Income derived by (i) a long-term lessee, (ii) a short-term lessee of a building by sub-letting or reletting the premises must be taxed as income from (a) business, (b) capital gains, (c) other sources, (d) house property, (e) profession. ( )

29. The ownership of property resulting in liability to tax is to be determined with reference to the (a) calendar year, (b) accounting year, (c) financial year, (d) assessment year of the assessee, ( )

30. Municipal taxes are deductible from annual value of the house (a) in full if the house was built before 1-4-1951 (b) 50% if the house was built after 1-4-1951, (c) in full, irrespective of the date of construction of the house. ( )

31. House occupied by the owner for purposes of his own residence also qualify for deduction in respect of municipal tax—this statement is (a) right (b) wrong. ( )

32. Newly built residential units qualify for deduction from annual value (a) in all cases. (b) only if they are let out. (c) only if they are occupied by the owner for purposes of his own residence, (d) if they are mortgaged or leased out. ( )

33. The amount of deduction allowable in respect of new residential units shall not exceed. ( )

(i) started after 1-4 1961 and completed after 1 4-1978 ( )

(ii) started after 1-4-1961 and completed after 31-3-1982. ( )

(a) Rs. 800, (b) Rs. 1,200, (c) Rs. 3,600, (d) Rs. 2,400 per each unit.

34. The allowance for newly built houses is permissible for a maximum period of (a) 6 years, (b) 3 years, (c) 2 years, (d) 8 years, (e) 5 years. ( )

35. The allowance for newly built residential units is to be computed from (a) the date of completion of the building (b) the end of the previous year in which the construction was completed, (c) the financial year of completion, (d) the end of the relevant assessment year. ( )

36. The buildings which are occupied by the owner for purposes of his own residence qualify for a deduction.

(i) (a) 40% (b) 25% (c) 60% (d) 50% of the annual value; or ( )

(ii) (a) 1,200 (b) Rs. 1,800 (c) Rs. 2,600 (d) Rs. 5,000 whichever is less.

37. The adjusted annual value of house property occupied by the owner for the purposes of his own residence should be limited to (a) 25% (b) 30% (c) 10% (d) 15% (e) 50% of the total income of the assessee from all sources other than such residential house. ( )

38. The concessional treatment available to self-occupied residential house is permissible for (a) only one house (b) any number of houses, (c) five houses, (d) two houses only. ( )

39. The deduction allowable in computing the income from house property in respect of repairs is a sum equal to (a) 1/5th, (b) 1/6th, (c) 1/8th or the adjusted annual value of the house. ( )

40. The deduction in respect of repairs is allowable in respect of (a) only those houses which are let out, (b) only self-occupied residential houses (c) all houses even if the assessee had not incurred any expenditure for repairs, (d) all houses let out for business or professional purposes. ( )

41. Expenses incurred for collection of the rent are allowable as a deduction subject to a maximum of (a) 6% (b) 8% (c) 1/6th (d) 1/10th of the adjusted annual value of the houses let out. ( )

42. The amount deductible for vacancy of the houses let out is (a) 1/4th (b) 1/6th, (c) 1/8th of the annual value or (d) that part of the annual value proportionate to the period of vacancy. ( )

43. Interest on mortagge of the house property is allowable as a deduction from the adjusted annual value (a) in all cases of usufructury mortgage, (b) in cases of mortgage for the construction, reconstruction, repair or renovation of the building, (c) in all cases of mortgage irrespective of its purpose, (d) only in cases of mortgage involving properties of values of Rs. 50,000 and above ( )

Answers :—1 (c). 2 (d), 3 (a) 4 (d). 5 (i) (c), (ii) (c). 6 (a). 7 (i) (b), (ii) (d), (iii) (a) 8 (c). 9. (d). 10 (b). 11 (b). 12 (b). 13 (c). 14 (a) 15 (a) 16 (d). 17 (c). 18 (a) 19 (a). 20 (c) 21 (e), 22 (b). 23 (d). 24 (b). 25 (d). 26 (b). 27 (e). 28 (i) (d) (ii) (c). 29 (b). 30 (c). 31 (a). 32 (b), 33 (i) (d) (ii) (c). 34 (e) 35 a). 36 (i) (d). (ii) (b). 37 (c). 38 (a). 39 (b). 40 (c). 41 (a). 42 (d). 43 (b).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL F.S.P. I. Tax—

FINAL COURSE

INCOME-TAX

STUDY—III

Computation of Income Under Different Heads

Contents :
1. Profits and gains of business or profession (Sections 28 to 44D).

2. Capital gains (Sections 45 to 55A).

3. Income from other sources (Sections 56 to 59).

4. Set-off and carry forward of losses (Sections 70 to 80).

1. *PROFITS AND GAINS OF BUSINESS OR PROFESSION*

(Sections 28 to 44D)

1.1. General : The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, *carried on by him or on his behalf during the previous year.* The term "business" has been defined in Section 2(13) to "include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". But the term "professions" has not been defined in the Act. It means an occupation requiring some degree of learning. Thus a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and, even an astrologer are persons who can be said to be carrying on a profession but not business. The term 'profession' includes vocation as well [Section 2(36)]. However it is not material whether a person is carrying on a 'business', 'profession' or 'vocation' since, for purposes of assessment, profits from all these three sources are treated and taxed alike.

Business necessarily means a continuous exercise of an activity; nevertheless, profit from a single venture in the nature of trade would be assessable if the venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of developement; divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on the individual sales of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the cost of all the plots and expenditure incidental thereto and has a surplus left.

Profits may be realised in money or in money's worth, *i.e.*, in cash or in kind. Whether profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this Section. Payments voluntarily made by persons who were under no obligation to pay anything at all would be income in hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

Application of the gains of trade is immaterial. Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of Section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year, not necessarily, by the assessee-owner personally, but it should be under his direction and control. For example, if a Court intervenes and deprives the owner of the right to carry on his business and authorises someone else to cary on the business, the owner would not be chargeable to tax under this Section.

The charge is not on the gross receipts but on the profits and gains in their natural and proper sense. Profits are ascertained on ordinary principles of commercial trading and commercial accounting. The Act has not prescribed any method for the purpose. Taxable income has, therefore, to be computed in accordance with the method of accounting regularly and consistently employed by the assesee; if no method of accounting has been regularly employed by the assessee or the method employed is such that income, profits gains cannot be properly deduced therefrom, the income-tax authorities may compute the income on such basis and in such manner as they deem fit. The assessee may account for his receipts on the cash basis or mercantile basis, as he chooses.

The Act, however, contains certain provisions for determining how the income is not to be assessed. These must be followed in every case of business or profession. The illegality of a business, profession or vocation does not exempt its profits from tax; the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises once income arises to the assessee ; *the motive or purpose of earning the income is immaterial.* Thus profit motive is not essential for describing the income from that activity as income from business or profession.

The profits of each distinct business must be computed separately but the tax chargeable under this Section is not on the separate income of every distinct business but on the aggregate of the profits of all the businesses carried on by the assessee. Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation *unless* the loss is, either expressly or by necessary implication, disallowed by the Act under Sections 30 to 43 A.

Income arising from business assets which are temporarily let out *e.g.*, an oil mill, cinema theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as business income. But if the commercial asset is permanently let the income is taxable as income from house property or income from other sources.

1.2 Income chargeable under the head 'Profits and Gains of Business or Profession'. (Section 28). The various items of income chargeable to tax as income under the head profits and gains of business or profession are as under :—

(i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.

(ii) Any compensation or other payment due to or received by :—

(a) Any person, by whatever name called, managing the whole or substantially the whole of (i) the affairs of an Indian company or (ii) the affairs in India of any other company at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;

(b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto;

(c) any person, for or in connection with the vesting in the Government or any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business;

(iii) Income derived by any trade, professional or similar associations from specific services rendered by them to their members :

(iv) The value of any benefit or perquisite whether convertible in money or not, arising from business or the exercise of any profession.

By taking compensation received on termination of agency or on the takeover of management (which is a capital receipt) as income from business, Section 28 (ii) provides exception to the general rule that capital receipts are not income taxable in the hands of the recipient

Similarly clause (iii) to Section 28 forms an exception to the general principle governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations *etc.* As a result a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose it is not necessary that the income received by the association should be definitely or directly related to these services.

Of late, a practice has been growing among professional men to secure some benefit or perquisite from their clients *e.g.*, advocate from Bombay or Calcutta on his visit to Delhi to appear before the Supreme Court may be put up by the client at luxurious hotel at his cost. Where, the relationship between the recipient of the benefit or perquisite and its giver is that of employee and employer or employee-director and company, the value of such a benefit or perquisite would be taxable as salaries [Sections 15 and 17 (2) (iii)]. But this provision of law cannot be invoked to tax a perquisite when provided to a professional man. On this account clause (iv) to Section 28 provides that the "value of any benefit," whether convertible into money or not, arising from business or the exercising of a profession shall be treated as income chargeable to tax as profits and gains of business or profession.

According to Explanation I to Section 28 the profits and gains of managing agency must be considered as profits and gains of a business in every case.

Speculation Business : Explanation 2 specifically provides that when a business is carried on in speculative transaction, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because Section 73 further enacts that losses in speculation business unlike

other business losses, cannot be set-off against the profits of any other business except those of the same or some other speculation business. Likewise, a loss in speculation business carried forward to a subsequent year can be set-off against the profits and gains of *any* speculative business in the subsequent year. Profits and losses resulting from speculative transactions must, therefore, be treated as separate and distinct from other profits and gains of business and profession.

According to Section 43(5) the expression "speculative transaction" means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Further, in view of explanation to Section 73 the transactions of purchase and sale of shares by non-banking and non-investment companies must also be deemed to be speculative transactions for tax purposes. However, the following three forms of transactions shall *not* be deemed to be speculative transactions:

(i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him;

(ii) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation;

(iii) a contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member.

Thus, in all the cases where actual delivery or transfer of the commodity or scrips takes place, the transaction would not amount to speculative transaction, however highly speculative it may be in its nature. The actual delivery may be symbolic and includes delivery effected by the mere transfer of delivery orders according to trade practice.

The three instances stated above constitute the exceptions specifically provided by the Act, whereby certain transactions (*e g.*, hedging contracts) entered into by manufacturers and merchants in the course of their business to guard against the loss through price fluctuations are excluded from the definition of speculative transactions. This provision should be liberally construed to cover not only hedging forward contracts for purchase of goods but also such contracts for sale.

Recently, the Supreme Court held in CIT V Shantilal (P) Ltd. (1983) 14 Taxman that an award of damages for breach of contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. In this view of the matter, the court held that in a case where a company contracted to sell a certain commodity to a party but was unable to effect delivery due to a sharp rise in the price of the commodity and the

dispute which arose out of such breach of contract was settled by payment of damages as decided by an arbitrator, the transaction could not be described as a 'speculative transaction' within the meaning of Section 43(5).

3. **Computation of Income from Business** (Section 29): According to Section 29 the profits and gains of any business or profession are to be computed in accordance with the provisions contained in Section 30 to 43 A. It must however be remembered that the specific allowances and deductions stated in these Sections are not exhaustive. The Act further permits allowance of items of expense under the residuary Section 37(1) which has been added to extend the allowance to items of business expenditure not covered by other Sections, where these are allowable according to accepted commercial practices.

An item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on ordinary principles of commercial accounting. Thus in determining, whether, a particular item (other than those covered by Sections 30 to 37) is deductible from profits, it is necessary first to enquire whether the deduction is expressly or by necessary implication prohibited by the Act and then, if it is not so prohibited, to consider whether it is of such nature that it should be charged against incomings in the computation of the "profits and gains" properly so called. Accordingly a loss due to embezzlement by an employee and a contractual liability to undertake a development scheme at a future date, are allowable as deductions in computing the business profit without reference to any statutory provision for deductions. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though there is no specific provision in the Act for allowing such deductions. Examples of such losses are embezzlement, theft, robbery or destruction of assets, overdrawing by employees loss of stock in trade by damage or by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employees etc. However, if a business man having business connection with a non-resident is assessed as the agent of the non-resident under Section 161 in respect of the non-resident's income and is unable to recover from the non resident the amount of tax, he cannot claim it as a bad debt or business loss incidental to the trade on ordinary principles of commercial accounting as was held in *C.I.T. v. Abdullabhai Abdul Kadar (1961). 41 I.T.R, 545* (S.C.).

But where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of trade, any payment made as a result of such guarantee cannot be deducted as a business loss except in a case where the contract of guarantee is entered into, in the course of business pursuant to a trade or custom of which mutual accommodation is the essence *e.g.*, trader standing surety for one another. When the exact amount of loss incidental to the trade cannot be proved by the assessee for reasons beyond his control, the amount of the loss may be estimated by the I.T.O. from such material as is available. In all cases the loss allowable as incidental to the business must be the loss of current asset or stock-in-trade but not of a capital asset Thus loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is

under legal obligation or business necessity required to keep in till it would be allowable as losses incidental to the trade. Losses arising from payments made in advance to employees and money lent by the managed company to the managing agents which had become irrecoverable would be incidental to the business provided that the amounts paid in advance or as loan were so made with reasonable business prudence and hence would be deductible.

Loss caused by embezzlement is allowable as a deduction not necessarily in the year in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable. Normally when a businessman writes off the amount, it is a *prima facie* an evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as deduction in any year are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

The allowances specified in Section 30 to 43A are disjunctive and cumulative and not alternative or mutually exclusive. The expenditure specifically covered by each Section must be dealt with under that Section and should not be claimed or allowed under any other Section.

In respect of wasting assets or an exhaustion of capital no deduction is allowable from the income derived from such capital or wasting asset. Accordingly where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of the annuity. Likewise, in the case of a lease the capital cost of the lease is not allowed to be deducted over the life of the lease.

At times there can be substantial difference between the book figures of profits and those computed under the Act for purposes of assessment. It may be caused by under/over allowance of deductions or income being computed on a basis totally different from that adopted by the assessee.

4. Admissible Deductions :

(A) Rent, Rates, Repairs and Insurance for Buildings : Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purpose of his business, profession. However, where the premises are used partly for business and partly for other purposes only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction (Section 38). Where the assessee has sub-let a part of the premises the allowance under the Section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this Section. But where a firm runs its busi-

ness in the premises owned by one of its partners, the rent payable to the partner be allowable deduction to the extent it is reasonable and is not excessive.

Apart from rent, this Section allows deductions in respect of expenses incurred on account of repairs to buildings in case where (i) the assessee is the owner of the buildings or (ii) the assessee is a tenant who has undertaken to bear the cost of repairs to the premises. Even if the assessee occupies the premises otherwise than as a tenant or owner, *i.e*, as a lessee, licence or mortgagee with possession he is entitled to a deduction under this Section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land-revenue, local rates, municiple taxes and insurance in respect of the premises used for the purposes of the business of profession. Cesses, rates and taxes levied by a foreign Government are also allowed. Where the premises in respect of which these expenses are incurred are not utilised wholly for the purpose of the business, then, the deduction allowable should be of an amount proportionate to the user of the premises for the purposes of the business.

(B) Repairs and Insurance of Machinery, Plant and Furniture: Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession. In order to claim this deduction, the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. The word 'used' has to be read in a wide sense so as to include a passive as well as an active user. Thus insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the accounting year the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of the user.

The term 'repairs' will include renewal or renovation of asset but not its replacement or reconstruction. Also the deduction allowable under this Section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under Section 37(1).

The deduction allowable in respect of premiums paid for insuring the machinery, plant or furniture is subject to the following conditions: (i) The insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (ii) The assets must be used by the assessee for the purposes of his business or profession during the accounting year. (ii) The premium should have been actually paid (or payable under the mercantile system of accounting). The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this Section even if a part of it is returnable to the insured in certain circumstances. It does not matter if the payment of the claim will enure to the benefit of some one other than the owner.

In an interesting case C.I.T. v. Koroth Oil Mill Co. Ltd. (1982) 9 Taxman 104 (Ker) the assessee, engaged in processing sea foods, had constructed fishing boats fitted with engines of 40 HP. During the relevant accounting year, the assessee replaced them with 60 HP engines. There was no material on record to show that the engines needed replacement. The question was whether impugned expenditure was deductible u/s 31. Held that since a boat is neither machinery nor plant, nor furniture but a vessel repairs to the boats would not qualify for deduction under Section 31.

(C) Depreciation : Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets. The allowance of depreciation which is regulated by Rule 5 of the I.T. Rules, is subject to the following conditions which are cumulative in their application.

(a) *The assets in respect of which depreciation is claimed must be Buildings, Machinery, Plant or Furniture* : The depreciation in the value of any other capital asset cannot be claimed as a deduction from the business income. No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to the superstructure but not the land on which it has been erected. The term 'plant' as defined in Section 43(3) includes ships, books, vehicles, scientific apparatus and surgical equipment. The expression 'plant' includes part of a plant (e.g., the engine of a vehicle): machinery includes part of a machinery and building includes a part of the building. However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus Plant includes all goods and chattels, fixed or movables, which a businessman keeps for employment in his business with some degree of durability.

(b) *The assets should be actually used by the assessee for purposes of his business during the accounting year* : It is enough if the asset is used at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year. Thus, even if the asset is used for a fraction of the year the assessee would be entitled to the full amount of depreciation allowable at the prescribed rate.

If the assets are used not exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. No depreciation allowance at the prescribed rates can, however, be granted for the accounting year in which the building, machinery, plant or furniture ceases to the used for the business i.e. when it is sold, discarded, demolished or destroyed [Section 34(2) (ii)].

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilised by another person e.g., a lessee or licencee. The deduction on account of depreciation would be allowed under this Section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee In other cases where the letting out of such assets does not constitute the business of the

assessee the deduction on account of depreciation would still be allowable under Section 57 (iii).

(c) *The assessee must own the assets* : In the case of buildings the assessee *must own the superstructure* and not necessarily the land on which the building *is constructed. In such cases the assessee should be a lessee of the land on which the building stands* and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business. Further no deipeciation would be *allowable in respect of any capital expenditure* which the assessee may be *obliged to incur on the property belonging to the others.* In the case of assets acquired under the *hire purchase system* the allowance for depreciation would under Circular No. 9 of 1943 R Dis. No. 27 (4) I. T 43 dated 23-3-1943, be granted as follows:

1. In every case of payment purporting to be for hire purchase, production *of the agreement under which the payment is made, would be insisted upon* by the department.

2. Where the effect of an argeement is that the ownership of the asset is at once transferred on the lessee the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This, principle will be applicable in case where the lessor obtains a right to sue for arrears of instalments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in advance with the the terms of hire purchase agreement.

3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by the hirer should for all tax purposes be regarded as made up of (i) the consideration for hirer which will be allowed as a deduction in assessment and (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lesssee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of his allowance should be spread over the duration of the agreement evenly. If however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination or agreement,

For the purpose of allowing depreciation an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect

of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished, the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum. For the purpose of allowing depreciation the questions whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in instalments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation or investment allowance in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(a) *The assessee must furnish the prescribed particulars contained in section II of Annexure* B *attached to the form of return of income* : Failure on the part of assessee to furnish fully and correctly the particulars prescribed in the Annexure B would entitle the I.T.O. to refuse the deduction on account of depreciation.

(b) The aggregate of all depreciation allowances including initial depreciation granted to the assessee from year to year shall not in any case exceed its actual cost.

Classification of assets and Rates of Depreciation : (From 84-85 assessment year)

(*i*) *Buildings*

1. General rate 5%
2. Factory buildings excluding offices, godowns, officers' and employees' quarters, roads, bridges, culverts, wells and tubewell 10%
3. Purely temporary erections such as wooden structure 100%
4. For renovation or improvement the percentage as may be appropriate to the class of building in relation to which such renovation is effected
5. For extension, the percentage as may be appropriate if the work constituted a separate building.

(*ii*) *Furniture and Fittings*

General rate 10%

Furniture used in hotels, restaurants and boarding houses, schools, colleges and other educational institutions, libraries, welfare centres, meeting halls, cinema houses, theatres and circuses, hired furniture for functions 15%.

(*iii*) *Machinery and Plant*

General rate 15%

Special rates 20%, 30%, 40%, 100%

Note : In respect of plant and machinery which can be classified as energy saving devices the rate has been increased from 30% to 100%

(*iv*) *Ships*

1. *Ocean going ships*—To be calculated on actual cost
   (i) Fishing vessels with wooden hull 10%
   (ii) Other ships 5%
2. *Vessels ordinarily operating on inland waters* :
   (i) Speed boats 20%

(ii) Other vessels 10%

Basis of Depreciation Allowance : Under Rule 5 and Part I of Appendix I of the Income-tax Rules and depreciation allowable has to be calculated as a percentage of—

(i) the actual cost of the assets in the cases of ocean-going ships : and
(ii) the written down value in the case of any other asset being building, machinery, plant or furniture.

Written down Value [Section 43 (6)] : In the case of assets acquired by the assessee during the accounting year the written down value means the actual cost to the assessee. In the case of assets acquired before the accounting year, the written down value would be the actual cost of the asset acquired *less* the aggregate of all deductions actually allowed (and not allowable) in respect of depreciation. For this purpose any depreciation carried forward is deemed to be depreciation actually allowed [Section 43 (6) Explanation (3)]. If income is merely estimated and no depreciation is computed in any year, depreciation cannot be said to have been actually allowed.

In addition :

(i) When in the case of a succession to business or profession an assessment is made on the successor under Section 170 (2), the written down value of any asset shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to.

(ii) When any capital asset is transferred by a holding company to its subsidiary or *vice versa* then, if the conditions specified in Section 47 (iv) or (v) are satisfied, the transaction not being regarded as a transfer, the written down value of the transferred capital assets to the transferee-company shall be taken to be the same as it would have been if the transferor-company had continued to hold the capital asset for its business purposes.

(iii) In a scheme of amalgamation where any capital asset is transferred by the amalgamating company to the amalgamated company, and the amalgamated company is an Indian company, the written down value of the transferred capital asset to the amalgamating company shall be taken to be the same as it would have been if amalgamating company had continued to hold the capital asset for the purposes of its own business.

Actual Cost [Section 43 (1)] : The expression "actual cost" means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person. The actual cost of an asset to the assessee is very important because ; (a) the depreciation allowable in respect of ocean-going ships is based upon actual cost ; (b) the written down value of any asset is to be calculated with reference to its actual cost ; (c) the aggregate of all depreciation allowable to an assessee has to be restricted to the actual cost of the asset.

The actual cost of an asset to the assessee is the amount of capital expenditure incurred by him in respect of the acquisition, installation etc., of the asset and ex-

penses incurred to put the asset ready for the purposes of its use in the business. For this purpose, it is immaterial whether such expenses have been incurred at the time of acquisition of the asset or subsequently. The determination of the actual cost of assets is important inasmuch as depreciation as well as investment allowance are based on the actual cost. It has been judicially settled that interest on moneys borrowed by the assessee in the process of constructing and erecting its plant incurred before the commencement of production can be capitalised and added to the cost of fixed assets. Similarly, courts have held that the following items could be capitalised so as to form part of actual cost : preproduction overheads, additional cost on account of devaluation, interest paid on deferred payment instalments, bank guarantee commission for purchase of machinery, fees paid, etc, travelling expenses within and outside India, amounts spent by way of training to staff and amount paid to foreign collaborators for technical know-how, expenses on preparation of plans for construction, and similar incidental expenses incurred in the acquisition of the concerned asset and before the asset could be brought into use. However, if a factory is shifted to a new site, the expenses of transporting and reinstalling the plant cannot be treated as part of its actual cost and, consequently, would not qualify for depreciation. Where the assessee acquires the bussiness of another, the original cost to assessee would be the value at which the assets are taken over by him and not the original cost of those assets to the previous owner of the business. Similarly on a partition of a H U.F. if assets are divided amongst the members on a genuine valuation, the cost to the member who thereafter brings the assets for use into his business, would be the value at which he took over the same.

(i) Where an asset is used in the business after it ceases to be used for scientific research related to that business and a deduction on account of depreciation in respect of that asset has been made earlier, the actual cost of the asset shall be taken to be the actual cost of the assets to the assessee as reduced by any deduction allowed under [Section 35 (1)] in respect of that asset.

(ii) Where an asset is acquired by the assessee by way of gift, succession or inheritance, the actual cost of the asset to the assessee shall be (a) the written down value thereof in the hands of the previous owner for the previous year in which the asset is so re-acquired or (b) the market value thereof on the date of such acquisition, *whichever is less.*

(iii) Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business, or profession and the I.T.O. is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax (by-claiming depreciation with reference to an enhanced cost) the actual cost to the assessee shall be taken to be such an amount which the I.T.O. may, with the previous approval of the I.A.C., determine having regard to all the circumstances of the case.

(iv) In the case of an asset, which had once belonged to the assessee and had been used by him for the purpose of his business or profession and thereafter ceased

to be his property by reason of any transfer or otherwise is required by him the actual cost of the assessee shall be (a) the actual cost to him when he first acquired the asset less the depreciation actually allowed to him reduced by the loss deducted [*i.e.*, terminal allowance, under [Section 32 (1)(iii) or, as the case may be, increased by any profit assessed as under Section 41)] or (b) the actual price for which the asset is re-acquired by him, *whichever is less.*

(v) Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession after 28-2-1946, its actual cost to the assessee shall be the actual cost of building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee.

(vi) When any capital asset is transferred by a holding company, to its subsidiary company or by a subsidiary company to its holding company then, if the conditions specified in Section 47 (iv) or (v) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business.

(vii) In a scheme of amalgamation if any capital asset is transferred by the amalgamating company to the amalgamated company the actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business.

Types of Depreciation Allowance: The depreciation allowable under this Section is of five kinds *viz.* (a) Normal depreciation (b) Additional depreciation (c) Initial depreciation (d) Extra depreciation and (e) Terminal depreciation. These are discussed below:

(a) *Normal Depreciation*: The depreciation ordinarily allowable to an assessee in respect of his building, plant, machinery and furniture which are used for the purpose of the business is known as normal depreciation and is calculated at the prescribed rates on the basis of the actual cost of the assets in the case of ocean-going ships and on the written down value in the case of all other assets.

Under Section 3 of the Act the length of the previous year in certain circumstances may exceed a period of twelve months; likewise the previous year may also be a period which is less than 12 months *e g* , in the case of a newly set-up business or profession. In such case the amount of depreciation to which the assessee would be entitled is to be taken at a proportionate figure. In other words if in a particular case, the previous year consists of a period of 14 months and the depreciation calculated at the prescribed rates for an accounting period of 12 months is Rs. 24,000 the deduction to which the assessee is entitled on account of depreciation in respect of that previous year would be Rs. 28,000 *i.e.*, 24,000 × 14/12.

For ascertaining the written down value of the assets at the beginning of the next accounting year depreciation of Rs. 28,000 (and not Rs. 24,000) actually allowed to the assessee would be deductible from the actual cost or the written down value (brought forward) of the asset.

Machinery or Plant acquired for Rs. 750 or less: In respect of any machinery or plant (but not buildings or furniture) the cost of which does not exceed Rs 750 (Rs. 5000 from 84-85 asst year) the amount of the actual cost of such machinery or plant shall be allowed as a deduction by way of depreciation in the year in which the machinery or plant is first used in the business or profession.

(b) **Additional Depreciation:** With a view to stimulating investment during the new Five Year Plan period, the Finance Act 1980 has inserted a new clause (iia) in sub-section (1) of Section 32 of the Income-tax Act to provide for a further deduction in respect of additional depreciation in respect of new machinery or plant installed in certain cases. The main points to be noted in regard to this provision are as follows namely:—

(i) Additional depreciation will be admissible in respect of new machinery or plant installed after 31st March, 1980 but before 1st April, 1985. For this purpose, the expression "new machinery or plant" will have the same meaning as in clause (2) of the Explanation below clause (vi) of Section 32 (1) and will accordingly include second-hand machinery or plant imported from a foreign country if the following conditions are fulfilled, namely:

(a) Such machinery or plant was not, at any time, prior to the date of its installation by the assessee, used in India:

(b) such machinery or plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1922 or the Income-tax Act, 1961, in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the assessee.

(ii) Additional depreciation will not be admissible in respect of ships, aircraft, road transport vehicles, office appliances or machinery or plant installed in any office premises or in any residential accommodation. For this purpose, 'residential accommodation' includes accommodation in the nature of a guest house but does not include premises used as a hotel. Machinery or plant installed in hotels will, therefore, qualify for deduction on account of additional depreciation if other conditions laid down in this behalf are fulfilled:

Additional depreciation will also not be admissible in respect of any machinery or plant the whole of the actual cost of which is allowed as deduction, whether by way of depreciation or otherwise, in any one previous year.

(iii) Additional depreciation will be allowable only in respect of the previous year in which the machinery or plant is installed or, if the machinery

or plant is first put to use in the immediately succeeding previous year, then, in respect of that previous year. It should be carefully noted that additional depreciation will be admissible only in one year, *i.e.*, in the year of installation or if the machinery or plant is first put to use in the immediately succeeding previous year, then in respect of that previous year.

(iv) Additional depreciation will be allowed in an amount equal to 50 per cent of the normal depreciation allowance (excluding extra shift allowance and the extra allowance in respect of machinery or plant installed in any premises used as a hotel). Thus, where the assessee is entitled to depreciation allowance at the rate of 10 per cent in respect of certain machinery or plant and also to extra shift allowance on account of double or multiple shift working of the machinery or plant, the additional depreciation allowance will be 5 per cent of the actual cost of the machinery or plant.

(v) The additional depreciation allowance will be taken into account in determining the written down value of the machinery or plant for subsequent years, and accordingly, additional depreciation will be taken into account in calculating the balancing charge for determining the profits under Section 41 (2) of the Income-tax Act. The aggregate of the additional depreciation and normal depreciation (including multiple shift allowance) over the years will also not exceed the actual cost of the qualifying machinery or plant.

(vi) Additional depreciation will not be admissible if the machinery or plant is sold, discarded, demolished or destroyed in the previous year.

(vii) Where the machinery or plant is not exclusively used for the purposes of the business or profession, the additional depreciation, as in the case of normal depreciation, will be restricted to a fair proportionate part which the Income-tax officer may determine having regard to the user of such machinery or plant for the purposes of the business or profession.

(c) *Initial Depreciation for Staff Welfare Buildings* : Section 32 (1) (iv): Initial depreciation is allowable only in respect of buildings but not plant, machinery or furniture. All the following conditions must be fulfilled by an assessee in order to claim initial depreciation.

(i) The building must be new.

(ii) The erection of the building must have been commenced and completed after 31-3-1961.

(iii) The building must be used by the assessee solely for the residential purpose of the employees whose income chargeable under the head 'salaries' is Rs. 10,000 per annum or less.

(iv) The building must alternatively be used mainly by these employees as hospital, creche, school canteen, library, recreational centre, shelter, rest room or lunch room.

If all the above conditions are fulfilled the assessee would be entitled to a deduction by way of initial depreciation of a sum equal to 40% of the actual cost of the building. This deduction is allowable only in the first year in which the erection of the building has been completed.

(ii) *Initial Depreciation for Hotel Building*: With effect from 1-4-1968, an amount equal to 25% of the actual cost of construction of the new hotel building would be allowed as a deduction by way of initial depreciation. The conditions for the grant of initial depreciation in such cases are:

(i) The erection of the building must have been completed after 31st March, 1966.

(ii) The assessee should be an *Indian company*.

(iii) The company must be the owner of the building.

(iv) The company must use the building as a hotel.

(v) The hotel should, for the time being, be approved by the Central Government for this purpose.

(vi) The deduction is allowed only in repect of the previous year in which the erection of the building is completed, or if the building is first put to use as a hotel in the immediately succeeding previous year, then the deduction is allowed in respect of that latter previous year.

The amount of initial depreciation in both the above cases shall not be deducted for ascertaining the written down value of the assets, but the amount of initial depreciation must be taken into account for the purpose of computing terminal depreciation or balancing charge.

The Finance Act, 1983 has provided that with effect from assessment year 1984-85 the above initial depreciation will be deducted in calculating the W.D.V. of the asset. The new provision will apply only in respect of initial depreciation allowed in the A.Y. 1984-85 and later years. It will not affect the calculation of W.D.V. made in respect of buildings constructed in earlier years as no amendment is made in section 43 (6) which defines the W.D.V. of the asset.

(d) *Extra Depreciation* : Extra depreciation and extra shift allowance are allowable only in respect of machinery and plant but not building or furniture. Extra depreciation is allowed to hotels on the following conditions:

(i) The assessee must be an *Indian Company*.

(ii) The machinery or plant in respect of which this allowance is claimed must be installed in the premises of the company used by it for running a hotel.

(iii) It must be approved by the Central Government for the grant of development rebate at higher rates under Section 33.

(vi) The amount of extra allowance on account of depreciation shall be equal to 50% of the normal depreciation allowance. For this purpose 'normal depreciation allowance' means the amount of depreciation allowance other than extra shift depreciation allowance.

(v) **The extra depreciation allowance to hotels will be available only for the assessment year commencing from 1-4-1970 or later.**

Extra Shift Allowance : This is allowed in the case of factories on the following conditions :

(i) This allowance is available to all assessees.

(ii) It is allowable only where the concern claims such extra shift allowances.

(iii) The assessee can claim the allowance only if he works the machinery or plant in shift.

(iv) The amount of allowance should be in proportion to the number of days for which the factory has worked in shifts during the previous year which bear to the normal working days in the previous year.

For this purpose the normal number of working days for the previous year has been fixed at 240 days or the actual number of days for which the concern has worked during the year, whichever is greater. However in the case of a seasonal factory or concern the number of normal working days for the factory or concern would be 180 days or the number of days on which the factory has worked during the previous year, whichever is greater. For example, if a non-seasonal factory has actually worked on 270 days during the previous year out of which it worked triple shifts on 135 days and double shifts on 90 days the extra depreciation allowance for triple shifts working will be 135/270 *i.e.*, one-half of the normal allowance and for double shifts working 90/270 *i.e.* one-third of one-half (*i.e.*, 1/6th) of the normal depreciation allowance.

(v) The maximum amount of extra shift allowance shall be restricted to (a) an amount equal to 50% of the normal depreciation allowance in the case of double shift and (b) an amount equal to the amount of normal depreciation allowance in the case of triple shifts.

(vi) In both the cases the assessee must establish to the satisfaction of the I.T.O. that the factory has worked double or triple shifts for the required number of days.

(vii) No extra shift allowance shall be allowed in respect of any item of machinery or plant which has been specifically excluded by the inscription of letters "N.E.S.A." (meaning No Extra Shift Allowance) against it and also in respect of certain other items of machinery specified in Part I of Appendix I to the Income Tax Rules.

(e) *Terminal Depreciation* [Section 32 (i) (iii)] : The provisions for allowing terminal depreciation allowance are as under :

(i) It is allowable in respect of any building, machinery, plant or furniture used by the assessee for purpose of his business.

(ii) It is allowable in the accounting year in which the asset is *sold*, discarded, demolished or destroyed. Consfiscation of an asset illegally imported into India does not amount to demolition or destruction within the meaning of section 32 (1) (iii) so as to entitle the assessee to claim it as deduction—Cement Agencies Ltd. v. CIT (1983) 12 Taxman 110 (Bom.)

The word 'sold' as used in this section not only means the actual sale of the asset but also includes a transfer by way of exchange or compulsory acquisition under any law for the time being in force but does not include transfer in a scheme of amalgamation, of assets by the amalgamating company to the amalgameted company where the amalgamated company is bn Indian company.

(iii) The sale, destruction or demolition of the asset should take place in a previous year later than the year in which the asset was first brought into use by the assessee. In other words, if the asset is sold in the same year in which it was first put to use, the assessee would not be entitled to any allowance on account of terminal or normal depreciation. For the purpose of allowing terminal depreciation it is immaterial if the asset is sold while the business continues or after its closure and merely for the purpose of winding-up. Each discarded item must be considered separately for this purpose although the amounts allowable in respect of each item are aggregated to ascertain the amounts allowable. In respect of an asset which is wholly or partly destroyed, damaged etc., this allowance can be granted only for the previous year in which the property has been actually sold, discarded, destoyed or demolished, whichever is the earliest.

(iv) The amount of allowance—(a) in respect of property which is sold is the excess of the written down value over the amount of sale price ; (b) in respect of property discarded, demolished or destroyed it is the excess of the written down value over amount received in respect of insurance, salvage or compensation moneys together with the amount of scrap value if any.

(v) The amount of deficiency which is allowable as terminal allowance must be actually written off in the books of the assessee in order to claim this deduction.

It is enough if the amount of loss claimed as terminal depreciation is written off in the books of the assessee ; the law does not require that it should have been written off in the particular previous year in which the loss is claimed. [CIT v Aruna Sizing Mills (1981) 5 Taxman 279.]

In order to qualify for this allowance the business (in the course of which the asset relating to teminal depreciation has been used) must be carried on during the accounting year in which the assessee is entitled to this deduction. If the business had been discontinued earlier, the deduction cannot be claimed against the income from another business carried on by the assessee even if the discarded assets are used at their discarded value in the other business carried on by the same assessee.

Depreciation in the case of Ships : The depreciation allowance in respect of ocean-going steamers must be calculated on the basis of such percentage of the actual cost of the ship to the assessee as may, in any case or classes of cases or in

respect of any periods be prescribed by the Central Board of Direct Taxes. See the chart for rates.

Depreciation in the case of Motor Cars : No depreciation is allowed to any taxpayer in respect of any motor car manufactured outside India if such motor car is acquired by the assessee at any time after 28th February, 1975 and is used by him otherwise than in a business of running it on hire for tourists. In other words, in case of imported motor cars which are run in the business of using such cars for the purpose of tourist traffic, depreciation would be allowable on the actual cost of the motor car regardless of the amount of such cost. If, however, the motor car is used for any other purpose of the business or profession carried on by the assessee no depreciation would be allowable. Depreciation on indigenously manufactured cars would be allowed on the basis of their actual cost.

Depreciation on Rented Buildings : Section 32 (1A), provides that in eases where the assessee incurs at any time after 1-3-1970, any expenditure of a capital nature on any structure or work constructed or done by him or in relation to, or by way of renovation or extension of or improvement to, any building held by him under a lease or other right of occupancy and used for purposes of his business or profession, he will be eligible for the grant of depreciation allowance on such capital expenditure at the rate specified in the Income-tax Rules. This allowance, however, is not available on expenses incurred (i) in the year of termination of the lease or right of occupancy [Section 34 (2) (iii) or (ii)] or the year in which deduction at such expenses is allowed under [Section 35 (2) (iv)] *i.e.*, capital expenditure incurred for scientific research. The assessee will have the right to claim terminal depreciation on the lease or right of occupancy if the compensation money received in respect thereof is less than the written down value. Likewise, if the written down value is higher, the assessee will be liable to a balancing charge, [Section 41 (2A), 41 (5) and 59]. The above provision will apply, as far as may be, to the computation of income from other sources for the calculation of depreciation allowable under Section 57. In accordance with the above provisions Rule 5 and the Rate Schedule of depreciation given in Appendix 1 of the Income-tax Rules, 1962 have been amended to provide for the rate at which depreciation allowance is to be calculated in such cases.

Set off and Carry Forward of Depreciation : Unabsorbed depreciation has to be treated in the same way as any other business loss but *with one important difference i.e.*, there is no time limit for the carry forward and set off of unabsorbed depreciation. If the profits of a particular business are not sufficient to absorb the depreciation allowable under the Section, the allowance can be set off against the profits of any other business. If there are no business profits chargeable to tax or if the profits of all the business taxable under the head 'business or profession' are insufficient to cover the depreciation allowance, the amount of the allowance may be set off against income under *any* other head for the year. If still some part of the depreciation allowance remains unabsorbed it may be carried forward and set off against the income of the succeeding years under *any head without any time limit.* This is because of the fact that unabsorbed depreciation must be treated as part of

the current depreciation and should accordingly be set off against any income under any head as was held in *C.I.T. v. Jaipuria China Clay Mines (P) Ltd. (1966) 59 I.T.R.* 555 (S.C.). Even if the asset in respect of which the depreciation is allowable ceases to be owned by the assessee or even if the business in respect of which the depreciation was allowable is discontinued or sold by the assessee the right of carry forward and set off of the unabsorbed depreciation would not be affected so long as the assessee carries on some business or profession as a result of which the depreciation allowance under Section 32 becomes admissible to him. The Bombay High Court in CIT *v.* Estate & Finance Ltd., (1978) 111 ITR 119 held that if the intention of legislature had been to allow unabsorbed depreciation to be set off against the profits of a subsequent year only if the business in respect of which depreciation was allowed continued to exist in such year, it would have said so. The absence of such express provision is eloquent and can only be fairly constued in favour of the assessee that there was no such requirement.

However, the depreciation allowance to which an assessee is entitled cannot be passed on to another person by virtue of the transfer of the business in which the depreciation is computed. The exceptions to this rule are the one contained in Sections 72A and 78 and that too, in those cases and circumstances which are specified therein. Where the amount is recomputed on reassessment the assessment forward may be amended as a rectification of mistake under Section 155 (4).

Where the assessee is a registered firm or an unregistered firm treated as registered the above principles will apply equally in respect of the individual assessment of its partners. The unabsorbed depreciation allowance cannot also be assigned to the transferee of the business even if the transfer is made under a scheme of amalgamation, as defined in Section 2 (1A) and consequently the transferee of a business cannot (except in cases covered by the new Section 72A with effect from 1-4 1978) carry forward or set off the unabsorbed depreciation attributable to the period prior to the transfer.

Disallowance of Depreciation : Under Section 40A (5) (a) (ii) the depreciation allowable to any assessee in respect of an asset used by an employee, either wholly or partly for his own purpose or benefit should not exceed the limits specified in that clause. The benefits or perquisites (including depreciation on asset used by them) granted to an employee in excess of the limits stated therein are not deductible from the employer.

In the case of a Company, Section 40 (c) further provides that in cases where the assets are used by a director or a person having a substantial interest in the company or by a relative of the director or such a person, wholly or partly for his own purposes or benefit, the depreciation allowance would be granted only to the extent to which the allowance, in the opinion of the I.T.O, is not unreasonable or benefits derived or accruing to it therefrom.

Development Rebate (Section 33) : The provisions of Section 33 granting deduction on account of development rebate have got only academic importance now in view of the fact that the rebate is withdrawn for all practical purposes. The

provisions have, therefore, not been explained here in detail. Development rebate *was being granted in respect of new ships, new machinery or plant as well as second-hand ship or machinery or plant satisfying certain specified conditions.* The *allowance was subject to the conditions laid down in Section* 34 *(3)* regarding *creation of development rebate reserve and its non-utilisation for* certain prohibited *purposes and non-transfer of asset* in respect of which development *rebate* was allowed for *specified period of time Violation of the conditions* laid down in Section 34 *(3)* would involve withdrawal of the development rebate allowed earlier. Though the rebate as such is not available now, the continued compliance of such *conditions might* be *necessary* even now in cases where the specified period is not expired for instance, one of the conditions of which governed the grant of development rebate was that the assessee should have created a development rebate reserve of an amount equal to 75% *or more* of the development rebate actually allowed by debiting the Profit and Loss Account and crediting to a Reserve Account. The reserve so created should not be utilised for a period of eight years (a) for distribution by way of dividends or profit ; or (b) for remittance outside India as profits ; or (c) for creation of any asset outside India ; or (d) for any other purpose which is not the purpose of the business of the undertaking. However, this requirement in respect of creation of development rebate did not apply to certain special cases.

Another condition required that the asset should not be sold or otherwise transferred by the assesee to any person at any time before the expiry of *eight* years from the end of the previous year in which it was acquired or installed. If the asset is transferred in violation of this condition the development rebate would be treated as having been wrongly allowed to the assessee resulting in a mistake apparent from the records which will be rectified under Section. 155 *(5)*. However, this condition shall not apply (a) where the ship has been acquired or machinery, or plant installed before 1.1 1958 ; or (b) where the ship, machinery, or plant is sold or otherwise transferred by the assessee to the government, a local authority, a corportion established by a Central, State or provincial Act or a Government company ; or *(c)* where the sale or transfer of the asset is made in connection with the amalgamation of two companies or succession of a partnership firm by a company referred to in sub-section *(3)* or *(4)* of Section *33*. Violation of the above conditions regarding utilisation of development rebate reserve or the retention of the concerned asset would lead to amendment of the concerned assessment in which the allowance was granted and withdrawal of the allowance under Section 155 (5) treating it as a case of wrong allowance given to the assessee resulting in a mistake apparent from the records.

Carry forward and set-off of the Development Rebate : The provisions relating to carry forward and set-off of unabsorbed development rebate are similar to those relating to unabsorbed depreciation but with one important difference, *viz.*, the unabsorbed development rebate can be carried forward only for a maximum period of *eight* years.

(E) *Investment Allowance* : (*Section 32 A*) The Finance Act, 1976 has inserted Section 32A in the Income-tax Act with effect from Ist April, 1976 with a view to granting a deduction on account of investment allowance in computing the profits and gains of a business carried on by the taxpayer.

Investment allowance is admissible only to those taxpayers (whether corporate or non-corporate) who carry on a business and/or profession and the deduction is based upon the actual cost of the ship, aircraft, machinery or plant which is first put to use by the assessees for the purpose of their business. The amount of investment allowance is a sum equal to 25% of the ship, aircraft, machinery or plant, as the case may be.

Any new machinery or plant intalled to produce or manufacture any article or thing would entitle the assessee to this benefit. It is, however, essential that the article or thing produced by the machinery should be one which is not listed in the Eleventh Schedule to the Act. The Central Government has been specifically empowered to omit, by notification in the Official Gazette, any article or thing from the list given in the Eleventh Schedule [Section 32 A (2A)]. But in the case of small scale industrial undertaking the benefit of investment allowance will be allowable even if the article produced is the one listed in the Eleventh Schedule. Further, in cases of new machinery or plant the benefit of investment allowance would not be lost in cases where a part of the machine is used for the manufacture of any item listed in the Eleventh Schedule if it is mainly used for producing any item not listed in the Eleventh Schedule [Section 32 (2A)].

The investment allowance would be available at a higher rate of 35% of the actual cost of the machinery in cases where the new machinery is installed on or after 1-7-1977 but before 1-7 1982 to produce any item with the help of any technology or know-how developed in or, which is invented by, a laboratory owned or financed by the Government or a laboratory owned by a public sector company or university or by an institution recognised in this behalf by the prescribed authority. [Section 32 A (2B)]. The Finance Act 1982, has extended the benefit under this sub-section from 31-3-1982 to 31-3-1987. In other words the benefit conferred by this sub-section can be availed in respect of machinery installed before 1-4-87. The prescribed authority for this purpose is the Secretary, Department of Science and Technology, Government of India. This benefit could be claimed only if the asses see has acquired the right in respect of the technology or know-how and furnishes the requisite certificate from the prescribed authority. Such plant and machinery should not however be used for manufacture of any of the items listed in the Eleventh Schedule. This condition is applicable in the case of both small scale industrial undertakings and other undertakings.

The rate of investment allowance on new machinery and plant (which would assist in pollution control or protection of environment notified by the government installed in any industrial undertaking on or after 1.6.1983 has been increased from 25% to 30% [vide section 32A(2c) inserted by the Finance Act, 1983 with effect from 1.6.1983].

Investment allowance is granted in respect of ships and aircraft in the year ... acquired and in the case of machinery or plant, the deduc- ... the machinery or plant is installed. If however ... in which these assets are ... in which the ... year immediately following accounting

tion is granted in the year in which the year ... in the year ... acquired or the machinery or plant was these assets are first put to use in the ... year in which the ship or aircraft was acquired ... respect of the accounting year in which installed, then, the deduction is admissible in respect of the asset is put to use in a year later than the asset is actually put to use. If, however, the asset is put to use in a year later than the year of acquisition or in the immediately following year, no deduction or allow- ance would be admissible to the assessee. For instance, if a taxpayer, following the calender year as the accounting year, had acquired and installed new machinery or plant in his business after 1st April, 1983 and before 31st December, 1980, he should have put it to use before the end of 1980, or in any case before the end of 1981; if the asset was put to use in 1980 the deduction would be admissible in respect of business income computed for the accounting year ended 31st December, 1980. If, however, the asset was put to use in the year 1981, the deduction would be admissible in respect of the profits computed for the accounting year ended 31st December, 1981 the relevant assessment year being 1982-83. If the assessee who had acquired and installed a machinery in 1980 and had put it to use in 1982 no deduction on account of the investment allowance would be at all admissible to him even if the other conditions stipulated under Section 33A are fulfilled.

The assets, in respect of which investment allowance is admissible, are the following :—

(a) a new ship or new aircraft acquired after 31st March, 1976, by an assessee engaged in the business of operation of ship or aircraft;

(b) any new machinery or plant installed by an assessee after 31st March 1976 :—

(i) for the purpose of the business of generation and/or distribution of electricity or any other form of power; or

(ii) for the purposes of business of construction, manufacture or production of any one or more of the articles or things other than those that are listed in the Eleventh Schedule to the Income-tax Act; or

(iii) in a small scale industrial undertaking for the purpose of business of manufacture or production of any article or things.

(c) any new machinery or plant installed after 31.3.1983 but before 1.4.1988 for the business of repairs to ocean going vessels or other powered craft if the business is carried on by an Indian company and approved by Central government [effective from 1.4.1984 (Finance Act 1983)]

For the purpose of granting investment allowance, the expressions *'new ship' 'new aircraft'* or *'new machinery or plant'* must be taken to have the same meaning as given in the Explanation to Section *32* (1) (vi). Any industrial undertaking would be deemed to be a small scale undertaking for the purpose of granting investment allowance in cases where the aggregate value of the machinery installed in the business on the last days of the relevant accounting year for the purpose of the business of the undertaking is less than Rs. 20,00,000. In cases where the previous

year ended before 31st July 1980, this limit was Rs. 10 lakhs. In computing the aggregate value of the various items of machinery or plant the value of tools, jigs, dies and moulds must be excluded. For the purposes of computing the aggregate value the value of the machinery or plant, must be taken as follows :

(a) in the case of any machinery or plant owned by the assessee—the actual cost thereof of the assessee ; and

(b) in the case of machinery or plant hired by the assessee—the actual cost thereof as in the case of the owner of such machinery or plant.

The following items of machinery or plant would not however, entitle the owner of these assets to claim any deduction on account of investment allowance in view of the specific prohibition in the law for this purpose.

(a) any machinery or plant installed in any office premises or any residential accommodation, including any accommodation in the nature of a guest house ;

(b) any office appliance or road transport vehicle ;

(c) any ship, machinery or plant in respect of which the deduction on account of development rebate is admissible under Section 33 ; and

(d) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "profits and gains of business or profession" of any one accounting year.

For instance, the machinery or plant, the actual cost of which is less than Rs. 750 (5000 from 84-85 assot year) is allowed as deduction by way of depreciation under Section 32 in the year in which the expenditure is incurred. Similarly, capital expenditure on scientific research is allowed in full as deduction in the year in which the expenditure is incurred. It may be noted that development rebate was admissible under Section 33 even in respect of these items of assets.

The deduction of investment allowance is to be made from the total income of the assessee. The 'total income' for this purpose denotes income *after* deductions of development rebate or development allowance, wherever, applicable, but *before* making deduction under Section 32A in respect of investment allowance or under chapter VI-A (deductions from gross total income).

The deduction on account of investment allowance is also subject to the condition that the assessee should create an Investment Allowance Reserve. An amount equal to 75% of the investment allowance to be actually allowed has to be debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account called 'Investment Allowance Reserve Account'. In the case of ships a reserve of only 50% of the amount to be actually allowed is required to be created. The Investment Allowance Reserve amount like the Development Rebate Reserve, should not be utilised by the assessee during the period of *ten years* (as against eight years for the purpose of development rebate) for distribution as dividends or as profits or even for remittances

outside India as profits or for the creation of any assets outside India. The conditions in this regard are identical to those followed for development rebate and hence these have not been discussed again.

Unlike the case of utilisation of development rebate reserve, a further condition has been imposed under the provisions of Section 32A (4) (ii) (a) to the effect that the amount of investment allowance reserve must necessarily be utilised by the assessee before the expiry of a period of ten years immediately following the accounting year in which the ship or aircraft was acquired or the machinery or plant was installed, for the purposes of acquiring a new ship or a new aircraft or new machinery or plant, as the case may be. The new machinery or plant or the ship or air craft acquired by the assessee should be such that it entitles the assessee to claim investment allowable thereon. In other words, the reserve should not be utilised for acquisition of any assets other than those in respect of which investment allowance is admissible to the assessee. Further during the period for which the reserve is to be maintained by the assessee, the amount of reserve should not be utilised for any purpose of the business of that undertaking of the assessse. If there are different business undertakings owned and carried on by the same assessee and the investment allowance is allowable in respect of one unit for which the required reserve has been created, the amount of the reserve should not be utilised by the assessee for being used for any other purpose, including the purchase of machinery or plant for being installed in any other business undertaking or unit run by him. There are no conditions of the type mentioned in this paragraph for the purpose of allowing development rebate.

In cases where the amount of Investment Allowance Reserve created by the assessee by debiting his profit and loss account of the relevant accounting year is less than the amount which should have been created by the assessee by way of reserve on the basis of the income of the assessee for the relevant accounting year, the Income Tax Officer has been empowered to give the assessee an opportunity to make good the deficiency in the amount of reserve created by him in order to qualify for the full deduction on account of investment allowance admissible. (It must be noted that there was no provision under Section 33 for allowance of development rebate to enable the Income Tax Officer to allow the assessee an opportunity to make good the deficiency in the reserve credited by him). This opportunity is available to taxpayers only in cases where the returned income of the assessee and the assessed income happen to be different and the enhancement of the assessee's income by the Income-Tax Officer is not due to the operation of the Proviso to sub-section (1) of Section 145 or sub-section (2) of Section 145 or the omission by the assessee to disclose his income fully and truly. In other words, in cases where the accounts of the assessee have been rejected by the tax authority on account of the incorrect and incomplete nature of the accounts and records maintained by the assessee or because of the falsification of the book of account or concealment of income, as would not be entitled to an opportunity to be given by the Income-tax Officer to make good the deficiency in the reserve created by him and consequently the investment allowance would be denied in such cases.

For the purpose of granting the assessee an opportunity to create additional reserve it would be necessary to see whether the accounts of the assessee for the relevant accounting year have been made up at the time when the assessment is made by the Income-Tax Officer. If the accounts have been made up, the Income-Tax Officer would give a notice to the assessee authorising him to create an additional reserve by charging the same to profit and loss account and by crediting the investment allowance reserve account. If, however, the accounts for the year have already been made up the Income-Tax Officer would authorise the assessee to create the additional reserve from out of the income of the immediately following accounting year and allow the deduction on account of the investment allowance. The reserve so credited in the subsequent year would not, however, be again taken into account in determining the assessee's entitlement to claim investment allowance and to ascertain whether the condition for creating the reserve has been complied with by him in respect of the immediately following accounting year for the purpose of granting investment allowance for the year.

Like the case of assets in respect of which development rebate was admissible, the assessee is required to ensure that the assets in respect of which investment allowance is granted are not sold or otherwise transferred before the expiry of the period of eight years except in cases of—(i) amalgamation of companies, (ii) conversion of a partnership firm into a limited company and/or (iii) transfers of the assets to the Government, a Government company, a Statutory corporation or a local authority.

For this purpose, the amalgamation should be one which falls within the meaning of the definition given in Section 2 (1A) and the amalgamated company must continue to fulfil the conditions stated above in respect of reserve and sale or transfer of the asset. If these two conditions are satisfied the amalgamated company would be entitled to carry forward the unabsorbed investment allowance, if any, in the same manner and to the same extent as the amalgamating company would have been entitled.

The succession of firm by a company referred to above should fulfil three conditions, viz

(i) all the property of the firm relating to the business immediately before the succession must become the property of the company ;

(ii) all the liabilities of the firm relating to its business immediately before the succession must become the liabilities of the company ; and

(iii) all the shareholders of the company must have been the partners of the firm immediately before succession.

In addition, the assessee should ensure that, within a period of ten years from the end of the previous year in which the ship or aircraft was acquired or the machinery or plant was installed, the amount of reserve is actually utilised by him for the acquisition of a new ship, aircraft or machinery or plant in order that the allowance previously granted is not withdrawn. In other words, besides not utilising the investment allowance reserve for distribution as dividends or profits

or for the creating of assets outside India, the assessee must also ensure that it is necessarily utilised for acquiring a new ship, aircraft, machinery or plant within ten years. The provisions of Section 155 (4A) would apply to treat the case as one of rectification of mistake apparent from the record for the withdrawal of the allowance previously granted to the assessee in cases where (i) the asset is sold within a period of 10 years or (ii) the reserve is utilised for distribution as dividends or profits or for the creation of assets outside India and (iii) even in cases where the reserve is not utilised within a period of 10 years for acquiring the new assets as required under the provisions of Section 32A. The time limit for rectification would be a period of four years from the end of the accounting year in which the condition/s for the allowance is/are not fulfilled.

Like the case of development rebate the Central Government has been specifically empowered to withdraw the deduction on account of investment allowance by notification in the Official Gazette if it considers it necessary or expedient to do so. The Central Government would give three years' notice in advance before any withdrawal of the allowance takes place. The other provisions relating to the deduction of the amount of the investment allowance, the order of priority in which the brought forward amount of investment allowance and also the current investment allowance will have to be set off are similar to those followed for development rebate. Therefore, students may refer to the discussion under the topic 'development rebate' in respect of the various matters wherever the provisions are identical.

(F) **Development Allowance** (Section 33A): Development allowance is similar to development rebate and it was introduced with effect from 1-4-1965 with a view to encouraging the development and modernisation of the tea industry. Development allowance has the following features :—

(i) It is allowable only in case of assessee carrying on the business of growing and manufacturing tea in India.

(ii) It is granted on the basis of the actual cost of planting or replanting tea bushes.

(iii) It is available not only in respect of tea bushes planted by an assessee on the lands owned by him but also on the land in respect of which he has a leasehold right or other right of occupancy.

(iv) It is allowed in two stages.

The conditions for granting development allowance and the provisions relating to carry forward and set-off of unabsorbed development allowance are broadly similar to those for allowing development rebate.

In order to qualify for deduction by way of development allowance (i) the planting of tea bushes must have commenced after 31-3-1965 in the case of new plantations and (ii) the planting should have commenced after 31-3-65 and completed before 1-4-1970 in the case of tea bushes which have been planted in replacement of those which have died or have become permanently useless. Rule 8A of the

Income-tax Rules, 1962 specifies the following conditions for the purposes of granting development allowance.

(i) The assessee must, at least three months prior to the commencement of operations for planting or replanting tea bushes, give a notice to the Tea Board of his intention to do so in Form No. 4.

(ii) The assessee should afford the Tea Board or such other person or agency as may be authorised in writing by the Tea Board in this behalf, every reasonable facility to enter upon and inspect the area under planting, or replanting, as the case may be.

(iii) The assessee shall furnish to the Tea Board such particulars, documents or statements relating to the planting or replanting of tea bushes, as the Tea Board may require him to furnish.

(iv) The assessee must furnish to the I.T.O. along with his return of income for the previous year in respect of which the deduction is claimed, a certificate from the Tea Board in Form No 5 and a statement of particulars in Form No. 5A.

Rates of Development Allowance :	*Percentage of actual cost of planting*
(i) If the tea bushes are planted on virgin soil (*i.e.* land not planted at any time with tea bushes)	50%
(ii) If the tea bushes have been planted on land previously abandoned.	—do—
(iii) If the tea bushes are planted in replacement of those which have died or become permanently useless, on any land already planted with bushes (*i.e.* replantations)	30%

For the purposes of calculating the development allowance the expression actual cost of planting means the aggregate of—

(i) the cost of preparing the land ;
(ii) the cost of seeds, cuttings and nurseries :
(iii) the cost of planting and replanting ; and
(iv) the cost of upkeep thereof for the previous year in which the land has been prepared and the three accounting years immediately succeeding the year.

In order to ascertain the actual cost of planting to the assessee, the aggregate of all the four items of cost must be reduced by that portion of the cost, if any, as has been met directly or indirectly by any other person or authority. However, if the actual cost of planting arrived at, as aforesaid, exceeds (i) Rs. 12,500 per hectare in respect of land situated in hilly areas or (ii) Rs. 10,000 per hectare in any other area, then the excess shall be disregarded.

The deduction in respect of development allowance is granted in two stages. The deduction is first allowed in computing the profits of the second accounting

year reckoned from the accounting year in which the land was prepared for planting, with reference to the actual cost of planting upto that year.

The deduction is next allowed in computing the profits of the fourth accounting year reckoned from the accounting year in which the land was prepared for planting. The quantum of allowance to be allowed at the second stage is equal to the difference between (a) the amount of development allowance computed in respect of the actual cost of planting incurred during the four accounting years and (b) the development allowance allowed at the first stage, i.e., in respect of the second accounting year.

The Finance Act, 1981, has also raised the monetary ceiling limits for the cost of planting for, the purpose of the grant of development allowance in the following manner:

	Rs.
(i) for the gardens situate in the planes	30,000
(ii) for the gardens in hilly areas other than Darjeeling district	35,000
(iii) for tea gardens situate in hilly areas of the District of Darjeeling	40,000

The above amendments are effective from the assessment year 1982-83 and subsequent years.

If an assessee who is entitled for development allowance transfers his right in regard to the land taken by him on lease, the allowance previously granted to him in his assessment would become liable to be withdrawn by treating it as a case of rectification of mistake under Section 155 (5A) of the Income-tax Act.

Order of Priority for Various Allowances : The combined effect of the provisions of Sections 32, 33, 33A, and 72 is that in the nature of depreciation allowance, investment allowance, development rebate, development allowances and losses, such allowances and losses would be deductible in the order given below, in cases where the profits are insufficient to absorb all of them :

(i) Current depreciation [Section 32 (1)].
(ii) Brought forward business loss of earlier years [Section 72(1)].
(iii) Unabsorbed depreciation of earlier years [Section 32 (2)].
(iv) Unabsorbed development rebate of years [Section 32(2) (ii)].
(v) Current development rebate [Section 33 (2) (i)].
(vi) Unabsorbed development allowance of earlier years [Section 34A (2) (ii)].
(vii) Current development allowance [Section 33A (2) (i)].
(viii) Unabsorbed investment allowance of earlier years [Section 32A(3) (iii)]
(ix) Current investment allowance [Section 32A (3)(i).

Thus unabsorbed depreciation will have priority over unabsorbed development rebate investment allowance for purpose of set-off against income in subsequent years. In case where the unabsorbed development rebate or unabsorbed investment allowance is not set off within eight years the assessee's right to carry

forward the same lapses and he would not be entitled to this deduction after that period.

(C) **Rehabilitation Allowance** Section 33 B allows a deduction in case where the business of any industrial undertaking is discontinued in any previous year on accont of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee and used by him wholly and exclusively for the purpose of the business as a direct result of any of the specified circumstances and within a period of three years from the end of that previous year in which the business is re established, reconstructed or reviewed by the assessee. The amount of deduction by way of rehabilitation allowance shall be a sum equal to 60% of the amount of the terminal depreciation due to the assessee under Section 32 (1) (iii) in respect of building, machinery, plant or furniture which is so damaged or destroyed. The deduction will be allowed in computing the business income of the assessee in respect of the previous year in which the business is re-established, reconstructed, or revived. The specified circumstances referred to above are :

(i) flood, typhoon, hurricane, cyclone, earthquake or other conclusions of nature; or

(ii) riot or civil disturbance ; or

(iii) accidental fire or explosion ;

(iv) action by an enemy or action taken in combating an enemy, whether with or without declaration of war.

For the purpose of claiming rehabilitation allowance the industrial undertaking must be one engaged in the business of generation and/or distribution of electricity or any other form of power or in the construction of ships, or in the manufacture or processing of goods or in mining.

Expenditure on Scientific Research (*Section 35*) : This Section allows deduction in respect of any expenditure on scientific research related to the business of assessee. The expression 'scientific research' as defined in Section 43(4) (i) means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. A reference to expenditure incurred on 'scientific research' would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does *not* include any expendiure incurred in the acquisition of rights in or arising out of scientific research. In particular, a reference to scientific research related to a business or class of business would include—(i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be ; (ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

The deduction allowable under this Section consists of—

(a) Any revenue expenditure laid out by the assessee himself on scientific research *related to his business*. Expenditure incurred within three years immediately preceding the commencement of the business on payment

[illegible] salary to research personnel engaged in scientific research related to the business carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business commenced. The deduction will be available only in respect of expenditure incurred after 31st March 1973 and will be limited to the amount certified by the prescribed authority. The amount deductible as is subject to the limit prescribed under Section 40A(5).

(b) Any sum paid to a university, college or other institution or scientific research association which has, as its object, the undertaking of scientific research to be used for scientific research provided that the university, college, institution or association is approved for this purpose by the prescribed authority.

Rule 6 of the Income-tax Rules specifies 'prescribed authority' for the purposes of Section 35, in relation to research in the fields of agriculture, animal husbandry and fishries, medical sciences, social sciences or statistical research and other natural or physical, pure or applied science. The expression, prescribed authority, for this purpose refers to the Indian Council of Agricultural Research, the Indian Council of Medical Research or the Indian Council of Social Science Research or the Secretary, Department of Science and Technology, Govt. of India or any other officer of that Department nominated by him in this behalf as may be appropriate to the nature of the scientific research in question (Rule 6). The payment so made to such institutions would be allowable irrespective of the fact whether (i) the field of scientific research is related to the assessee's business or not and (ii) the payment is of a revenue nature or of a capital nature.

(c) Any sum paid to an approved university, college or other institution to be used for research in any social science or statistical research related to *the class of business carried* on by the assessee.

(d) Any expenditure of a *capital nature related to the business carried* on by the assessee spread over a period of five consecutive years (one fifth in each year), if it was incurred prior to 1.4 1967. However, if such expenditure has been incurred *on or after* 1.4.1967 *the entire* amount of such expenditure would be deductible in full in the previous year in which it is incurred.

(e) Where the taxpayer pays after March, 1973 any sum to an approved scientific research association or university or, college or other institution for sponsored scientific research undertaken under a programme approved in this behalf. by the prescribed authority, he will be allowed a *weighted deduction equal to one and one-third times* the sum so paid. The sponsored research *need not* necessarily be related to the taxpayer's business. This is provided in sub-section (2A) of Section 35.

Capital expenditure incurred on scientific research which cannot be absorbed by the business profit of the relevant previous year can be carried forward

without any time limit in the same way as unabsorbed depreciation allowance. Thus, in a case, where both unabsorbed expenditure on scientific research and carried forward business loss have to be set off, the business loss must be set off first, since it would get lapsed at the end of the eighth year.

The Explanation added to sub-section (2) specifically provides that where any capital expenditure has been incurred *prior to the commencement of the business*, the aggregate of the expenditure so incurred within the three accounting years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the accounting year.

Amendments made by the Finance (No 2) Act, 1980: The Finance (No 2) Act, 1980 has made certain amendments in Section 35, relating to expenditure on scientific research. The effects of the amendments are explained below:

(i) Section 35 (2) (iv) has been amended with a view to clarifying that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under Section 30 whether in the year in which deduction under Section 35 was allowed or in any other previous year. This amendment has come into force with effect from the 1st April, *i.e.*, 1962 from the commencement of the Income-tax Act, 1961. The amendment has been made with a view to superseding the effects of certain judicial rulings.

(ii) The scope of the weighted deduction available under sub-section (2A) of Section 35 has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For this purpose, the expression "public sector company" means any corporation established by or under any Central or State or Provincial Act or a Government Company as defined in Section 617 of the Companies Act, 1956.

(iii) A new sub-section 2B has been inserted in Section 35 under which weighted deduction will be allowed in an amount equal to one and one-fourth times the expenditure incurred by an assessee on scientific research undertaken by him under a programme approved in this behalf by the prescribed authority having regard to the social, economic and industrial needs of India. The revenue expenditure and expenditure incurred on the purchase of machinery and equipment for carrying out the approved programmes will qualify for weighted deduction. However, it has been specifically provided that capital expenditure incurred on acquisition of land or acquisition or construction of buildings will not be allowable for this weighted deduction. The expenditure qualifying for this weighted deduction will be limited to the amount certified in this behalf by the prescribed authority. Where a deduction is allowed under this sub-section no deduction in respect of the same expenditure will be allowed under Section 35(1) or 35 (2) (1a) for the same or in any other previous year. Similarly, no depreciation will be allowed in respect of such expenditure either in the year in which the weighted deduction is allowed or in any other previous year.

(iv) Section 41 has been amended to provide that where such asset is ultimately sold, whether before or after being used in the business of the assessee, the sale proceeds will be included in the taxable income of the assessee. In order to ensure that this concession is not misused, it has been provided that the assessee will be required to furnish a certificate of completion from the prescribed authority after the programme of scientific research has been implemented and if the assessee fails to furnish such certificate within one year of the period allowed by the prescribed authority for completion of the programme, the tax concession already allowed will be withdrawn A suitable provision for enabling the withdrawal has been made in sub-section 5B of Section 155.

(v) The above two changes, *viz.*, the extension of the scope of sub-section 2A and the insertion of sub-section 2B are effective from 1st September, 1980, and will accordingly apply in relation to the assessment year 1981-82 and subsequent years.

The Finance Act, 1983, has amended section 35 (2A) to provide that with effect from assessment year 1984-85, the weighted deduction of 33⅓ % will be allowed to an assessee making a donation to a scientific research association approved under section 35 (1) (ii) for a project approved under section 35 (2A) only if the donor gives a specific direction that the amount donated shall not be used by the association for the acquisition of any land or building or for the construction of any building.

(I) Amortisation of Capital Expenditure on Acquisition of Patents and Copyrights : The provisions in this regard are as under: [Section 35A]

(i) Any capital expenditure incurred by an assessee after 28-2-1966 on the acquisition of patent rights or copyrights used for the purposes of the business will be allowed as a deduction in equal instalments over a period of *fourteen* years or 14 years as reduced by the number of completed years comprised in the period which has expired before the commencement of these rights and before their acquisition by the assessee, whichever, is shorter. If a full period of 14 years had expired before such acquisition, then the entire cost of acquisition will be allowed in one instalment in the year of acquisition.

(ii) If before the end of any of the relevant previous years for which the allowance is to be made, the right comes to an end without being subsequently revived or if the assessee sells the right for an amount which is not less than the capital cost of the rights remaining unallowed, the assessee shall not be entitled to any deduction in respect of the rights for the previous year in which the rights come to an end or are sold.

(iii) If the rights come to an end without being subsequently revived or are sold in their entirety and the sale proceeds are less than the cost of acquisition thereof remaining unallowed, then, the cost so remaining unallowed or such cost as reduced by the sale proceeds, as the case may be, shall be allowed as a deduction (*i.e.* terminal allowance) in full in the previous year in which the rights come to an end or are sold.

(iv) If the rights or any part thereof are sold and the capital sum received on the sale exceeds the cost of the rights remaining unallowed, then, the excess will be

charged to tax as profits (balancing charge) of the previous year in which the sale took place. But the amount so chargeable as profits shall be limited to the deductions already allowed to the assessee on account of these rights.

However, if only a part of the rights is sold for an amount which is not less than the capital cost remaining unallowed, the amount of deduction to be allowed to the assessee in respect of the previous year in which the sale takes place and the subsequent years, will be recomputed. The recomputation will be made by reducing the capital cost remaining unallowed from the sale proceeds and the balance will be allowed in equal instalments for the relevant previous year and the subsequent previous years.

(v) In a scheme of amalgamation, where the patent rights or copyrights are sold or otherwise transferred by the amalgamating company to the amalgamated company the provisions aforesaid in (ii) and (iv) above in respect of terminal allowance or balancing charge shall not apply to the amalgamating company but they will continue to apply to the amalgamating company in the same way and to the same extent as they would have applied to the amalgamating company had the amalgamation not taken place. Thus, in a case of amalgamation which falls within the meaning of the definition given in Section 2 (1A) the allowance under this Section does not get forfeited on the ground that there has been a transfer of the business.

Example: X spent Rs. 84,000 on patent rights in March, 1978. He started business in January, 1977 and closed his books on 31st March, 1978. In September, 1978 he sold a part of his rights for Rs. 52,000. How much allowance would be admissible to him for the previous year 1979-80?

	Rs
Cost for the previous year 1977-78	84,000
Less : 1/14th of Rs. 84,000	6,000
For the previous year 1978-79 allowance outstanding	78,000
Less: Value realised	52,000
Amount to be allowed over 13 years	26,000
For this year 1/13th of Rs. 26,000	2,000

(J) Export Markets Development Allowance [Section 35B]: Under Section 35B of the Income tax Act, *domestic companies and non-corporate assessees resident* in India are entitled to a weighted deduction, in the computation of their taxable profits, at the rate of *one and one-third time* the amount of the qualifying expenditure incurred by them on the development of export markets. The weighted deduction under this provision is allowed with reference to specified categories of expenditure having regard to the fact that the basic objective for the grant of a weighted deduction in respect of expenditure on development of export markets was primarily to provide an incentive for promoting exports on a continuing basis.

The Finance Act (No. 2) 1980 has amended Section 35B so as to limit the benefit of the weighted deduction only in respect of the following categories of expenditure, namely:

(i) Advertisement or publicity outside India in respect of the goods, services or facilities which the assessee deals in or provides in the course of his business.

(ii) Maintenance outside India of a branch office or agency for the promotion of the sale outside India of such goods, services or facilities.

(iii) Travelling outside India for the promotion of the sale outside India of such goods, services or facilities including travelling outward from and return to India.

(iv) Such other activities for the promotion of the sale outside India of such goods, services or facilities as may be prescribed in the Income-tax Rules.

In a notification issued recently, the CBDT has prescribed expenditure on conducting pre-investment surveys, preparation of feasibility reports or project reports at the written request of the Central Government or the foreign party, maintenance outside India of a warehouse for promotion of sale of goods outside the country, maintenance of a laboratory or other facilities for quality control or inspection of such goods and purchase of foreign trade periodicals or journals related to the business of the taxpayer.

The expenditure on maintenance of laboratory or other facilities for quality control will, however, be restricted to the amount which bears the same proportion as the export sales to the total turnover of the business in respect of which such laboratory or other facilities are maintained.

Explanation 2 below clause (b) of Section 35B (1) clarifies that any expenditure which, by its very nature, is debitable to the trading account or a manufacturing account of a business, such as wages to labourers, purchase of raw materials, carriage inward, etc., will not qualify for the weighted deduction.

It may be noted that the deduction is available irrespective of the consideration whether the assessee has exported any goods during the previous year or whether he has earned any profit out of these exports.

The Finance Act, 1983, has provided that expenditure incurred for any of the abovementioned purposes on or after 1-3-83 will not qualify for weighted deduction.

(K) Agricultural Development Allowance (Section 35 C) : This is a provision introduced by Finance Act, 1968, under which all companies (and co-operative societies with effect from 1-4-1976), engaged in agro-based industries involving the manufacture or processing of any article or thing which is made from or used in such manufacture or processing as raw materials, any product of agriculture, animal husbandry or dairy or poultry farming would be eligible for a weighted deduction in respect of expenditure incurred by them in improving agricultural inputs and

extension to person engaged in agricultural production, animal husbandry, or dairy or poultry farming. The weighted deduction will be of an amount equal to *one and one fifth times* the amount of qualifying expenditure. Thus, if a company has incurred an expenditure of Rs. 50,000 the amount of deduction would be Rs. 60,000. Only companies which use the products of producers as aforementioned, as raw materials in their industry shall be eligible for such deduction. Further, the expenditure incurred by the company after 29-2-1968 or co-operative society in respect of its accounting year relevant to the assessment year 1976-77 and the subsequent year in the provision of goods, services or facilities, specified hereunder shall qualify for the deduction:

(i) fertilizers, seeds, pesticides concentrates for cattle and poultry feed, tools or implements for use by such cultivator, grower or producer;

(ii) dissemination of information on and demonstration of modern techniques or methods of agriculture, animal husbandry, dairy or poultry farming, or advice on such techniques or method; and

(iii) such other goods, services or facilities as may be prescribed.

It has been clarified that the weighted deduction in respect of such expenditure shall be allowable *only if* :

(i) It is in the form of goods, services or facilities and *not* cash;

(ii) It is provided directly to cultivators, growers or producers in India of agricultural raw material; and

(iii) It is not paid to relatives or associate concerns referred to in Section 40A (2).

The expenditure is allowable only if it has been incurred by a company or co-operative society engaged in an agro-based industry. It is allowable also when it is incurred by the company on its own farm. It can also be incurred either directly or through an association or body which has been approved for this purpose by the prescribed authority. The expenditure in respect of which a deduction under this Section is allowed shall not again qualify for deduction under any other provision of the Act.

This benefit of weighted deduction has been withdrawn by the Finance Act, 1983, with effect from 1984-85 assessment year.

(L) **Rural Development Allowance** (Section 35CC): Section 35CC grants deduction by way of rural development allowance in computing the profits and gains of business. This new provision is effective from 1st September, 1977 and will, accordingly, apply for computation of income from business for the assessment year 1978-79 and subsequent years. The benefit of rural development allowance is admissible only to companies and co-operative societies. Therefore, non-corporate taxpayers other than co-operative societies do not qualify for this allowance. In the case of a company which qualifies for the deduction, the company may be an Indian or foreign company; it may be closely-held or widely-held and it may also be resident or non-resident for income-tax purposes. But it must be a company

within the meaning of the definition given in Section 2 (17) of the Income-tax Act. The deduction allowable under this provision is in respect of any expenditure on any programme of rural development incurred by the assessee during the previous year. The allowance of deduction is subject, however, to the condition that the approval of the prescribed authority specified in Rule 6AA of the Income-tax Rules must have been obtained by the assessee in respect of the programme of rural development before expenditure is incurred.

The Finance Act 1983 has added a proviso to 35 CC (1) whereunder the prescribed authority shall not approve any programmes unless such a programme is a programme falling within any such class or category of programmes of rural development as may be specified by the Central Government in this behalf.

For the purpose of this allowance a programme of rural development would include any programme for promoting the social and economic welfare of or the uplift of the public in any rural area. The expression *rural area* means any area other than—

(i) an area which is comprised within the jurisdiction of a municipality (whether known as a municipality, a municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board which has a population of not less than 10,000 according to the last preceding census for which the relevant figures have been published before the first day of the accounting year of the assessee ;

(ii) an area within such distance, being within 15 kilometers from total limits of any municipality or cantonment board referred to in (i) above as the Central Government may, having regard to the stage of development of such area including the expenditure on and the scope for urbanisation of such area and other relevant considerations, specify by notification in the Official Gazette for this purpose.

In cases where the expenditure incurred by the assessee towards rural development result in the acquisition or creation of any depreciable asset and the assessee does not divest itself of the ownership of such asset before the end of the previous year in which the expenditure was incurred, the assessee would not be granted any deduction in respect of such capital expenditure under Section 35CC ; but the assessee would be entitled to claim depreciation allowance in respect thereof as if the asset is used by it for the purpose of its business. Accordingly, the provisions of Sections 32, 34, 41 and 43 of the Income-tax Act relating to depreciation allowance and depreciable asset would, so far as may be, become applicable to the assessee.

Where the expenditure incurred by the assessee is of a revenue nature and the expenditure has been incurred after the business is set up the entire amount thereof would qualify for allowance. Likewise, the assessee would be entitled to the deduction under Section 35CC even in cases where the expenditure is of a capital nature; but it is essential that the assessee does not continue to be the owner

of the asset acquired by incurring the expenditure after the end of the accounting year; in such cases the entire amount thereof would be deductible as if it is a case of revenue expenditure. In every case where the deduction in respect of expenses on rural development is admissible under Section 35CC, the assessee would not qualify for any deduction in respect thereof under any other provision of the Income-tax Act.

The allowance of this deduction is also subject to the condition that the assessee should, along with his return of income for the relevant assessment year for which the deduction is admissible, furnish a statement of the expenditure qualifying for allowance which should be duly signed and verified by an accountant as defined in the Explanation to Section 288 (2) and setting forth such other particulars as may be prescribed by the Central Board of Direct Taxes in this regard.

(M) Contributions for rural development: (35CCA) (As amended by the Finance Act, 1983):

This section allows a deduction of the following expenditure during the previous year incurred by the assessee.

(1) Payment to an association or institution, having the objective of undertaking programmes of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority.

Conditions for allowance

(a) The assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that the programme of rural development had been approved by the prescribed authority before 1.3.83 and

(b) Where such payment is made after 28.2.83, the programme should involve work by way of (i) construction of any building, or other structure (to be used for dispensary, school, training or welfare centre, workshop, etc.) or (ii) the laying of any road or (iii) the construction or boring of a well or tubewell or (iv) the installation of any plant or machinery and such work must have commenced before 1.3.83.

(2) Payment to an association or institution having as its object the training of persons for implementing rural development programme.

Conditions: (a) Assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that it has been approved by the prescribed authority before 1.3.83.

(b) Such training of persons must have started before 1.3.83.

(3) Payment to a rural development fund set up and notified by the Central Government:

Condition: No particular condition is prescribed.

The expression 'programme of rural development' for this purpose has the same meaning as has been assigned to it under explanation to section 35CC (i).

It has been specifically provided that in every case where any deduction in respect of contribution for rural development is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to the approved association, or institution, no deduction in respect of the same expenditure can again be claimed by the assessee under Section 35C as qualifying for agricultural development allowance or Section 35CC as rural development allowance or in the nature of a charitable donation for which a deduction from the gross total income is admissible or under any other provision of the Income-tax Act in the same or any other assessment year. Unlike the provisions of Section 35CC under which rural development allowance is admissible only to companies and cooperative societies the deduction on account of contribution for rural development is admissible to all taxpayers, whether corporate or non-corporate carrying on business or profession.

Insertion of New Section 35CCB by the Finance Act, 1982

Contributions to Institutions or Associations for Conservation of Natural Resources (35CCB) : Section 35CCB has been inserted in the Income-tax Act by the Finance Act, 1982, with effect from 1st June, 1982. The Section provides for the deduction of any expenditure by way of sums paid to an association or institution whose object is the undertaking of any programme of conservation of natural resources to be used for carrying out any such programme approved by a prescribed authority. This deduction is available to all assessees. The deduction shall be allowed only if such recipient association or institution is for the time being approved in this behalf by the prescribed authority. The prescribed authority shall not grant such approval for more than three years at a time. Where a deduction under this Section is claimed and allowed for any expenditure for any assessment year, no deduction shall be allowed in respect of such expenditure under any other provision of the Act for that assessment year or for any other assessment year.

Amortisation of Preliminary Expenses (Section 35D) : 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns. This Section applies (a) only in respect of expenses incurred after 31-3-1973; (b) only to Indian companies and other resident persons but not to non-residents and foreign companies ; (c) in the case of new companies - to expenses incurred before the commencement of the business; (d) in the case of extension of an existing industrial undertaking—to expenses incurred till the extension is completed, *i.e.* in the case of setting up of a new industrial unit—to expenses incurred till the new unit commences production or operation. The assessee is entitled to a deduction of an amount equal to *one tenth* of the qualifying amount of the expenditure for each of the ten successive accounting years beginning with the year in which the business commences, or as the case may be, the previous year in which the extension of the industrial undertaking is completed or the new industrial unit commences production or operation.

The kinds of expenditures that are amortisable are the following :

1. Expenditure in connection with : (a) the preparation of feasibility report; (b) the preparation of project report ; (c) conducting market survey or any other survey necessary for the business of the assessee ; (d) engineering services relating to the assessee's business ; (e) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of assessee.

2. Where the assessee is a company, in addition to the above, expenditure incurred : (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company ; (g) on printing the Memorandum and Articles of Association ; (h) by way of fees for registering the company under the Companies Act ; (c) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission brokerage and charges for drafting, printing and advertisement of the prospectus; and

3. Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

In the case of expenditure specified in items (a) to (d) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or of any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

Overall Limits : The maximum amount aggregate of the qualifying expenses that can be amortised has been fixed at $2\frac{1}{2}\%$ of the cost of the project or in the case of an Indian company, at the option of the company, $2\frac{1}{2}\%$ of the capital employed in the business of the company, *whichever is higher*. The excess, if any, of the qualifying expenses shall be ignored.

The process of amortisation is the deduction of one-tenth of the qualifying expenditure for a period of ten years beginning from the year of commencement of business or completion or extension of the undertaking or commencement of production or operation of the new unit, as the case may be.

For purposes of amortisation, the expression, '*cost of the project*' means—

(i) in the case of expenses incurred before the commencement of business the actual cost of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences ;

(ii) in case of extension of the business or setting up of a new industrial unit the actual cost of the fixed assets being land, buildings, leaseholds, plant, machinery furniture, fittings, and railway sidings (including expenditure on the development

of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the industrial undertaking is completed or, as the case may be, the new industrial unit commences production or operation, in so far as such assets have been acquired or developed in connection *with the extension of the industrial undertaking or the setting up of the new industrial unit.*

The expression *"capital employed in the business of the company"* must be taken to mean—

(i) in the case of new company, the aggregate of the issued share capital, debentures and term borrowings as on the last day of the previous year in which the business of the company commences ;

(ii) in the case of extension of the business or the setting up of a new unit the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the accounting year in which the extension of the industrial undertakings is completed or, as the case may be the industrial unit commences production or operation in so far as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the industrial undertaking or the setting up of the new industrial unit of the company.

The expresssion *"long-term borrowings"*, mentioned above, means any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any banking institution, or any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

In cases where the assessee is a person other than a company or a co-operative society the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a chartered accountant and the assessee furnishes, along with his return of income for the first year in respect of which the deduction is claimed the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed. For further details reference may be made to Rule 6 AB and Form No. 3B and the Annexure thereto.

Where the undertaking of an Indian company is transferred, before the expiry of the period of ten years, to another Indian company in a scheme of amalgamation as defined in Section 2(1A) the aforesaid provisions will, as far may apply to amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place. But no deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

It has been claimed that in case where a deduction under this Section is claimed and allowed for any assessment year in respect of and item of expenditure,

the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any of the Act for the same or any other assessment year.

(P) Amortisation of Expenses for Prospecting and Development of Mines (Section 35 E) : This provision for amortisation of expenses for the prospecting for and development of mines was introduced by the Taxation Laws (Amendment) Act, 1970 with effect from 1-4-1971. This provision applies only to expenditure incurred by an Indian company or any other person who is resident in India. Thus foreign companies or foreign concerns and non-resident assessees are not entitled for the benefits of deduction under Section 35E. In order to qualify for amortisation the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral and the expenditure qualifying for amortisation should have been incurred at any time after 31st March, 1970.

The nature and kind of expenditure qualifying for amortisation are : (i) It must have been incurred by the assessee after 31-3-1970. (ii) It must have been incurred during the year of commerical production or any one or more of the four years immediately preceding that year (iii) It must be an expenditure incurred wholly and exclusive on any operations relating to the prospecting for or extraction of any of the 27 minerals of 16 groups of associated minerals or the development of a mine or other natural deposit of any such mineral or group of associated minerals specified in the Seventh Schedule to the income-tax Act.

However, any portion of the expenditure which is met directly or indirectly by any other person or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation. Further, specific provision has been made to the effect that the following items of expenses do *not* qualify for amortisation at all *viz* :

(i) Expenditure incurred on the acquistion of the site of the source of any minerals or group of associated minerals stated above or of any right in or ver osuch site;

(ii) Expenditure on the acquisition of the deposits of mineral or groups of associated mineral referred to above or of any rights in or over such deposits ; or

(iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under Section 32 of the Act.

The assessee will be allowed for each one of ten relevant previous years a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure Thus, the deduction to be allowed for any relevant accounting year is (i) one-tenth of the expenditure or (ii) such amount as will reduce to *nil* the income of that accounting year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amont

of the deduction admissible in respect of any relevant accounting year to the extent to which it remains unallowed, shall be carried forward and added to the instalment relating to the accounting year next following and shall be deemed to be a part of the instalment and so on, for ten accounting years ; beginning from the year of commercial production.

For purposes of this amortisation the expression "*operation relating to prospecting*" means any operation undertaken for the purpose of exploiting, locating or proving deposits of any mineral and includes any such operation which proves to be infructuous or abortive. The expression '*year of commercial production*' means the previous year in which as a result of any operation relating to prospecting commercial production of any material or one more of the minerals in a group of associated minerals specified in part A or Part B, respectively, of the Seventh Schedule to Act actually commence. The relevant previous year in which the deduction would be allowed to the assessee are those ten accounting years beginning with the year of commercial production.

Where a deduction is claimed and allowed on account of amortisation of the expenses under Section 35E in any year in respect of any expenditure the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profit and gains under any other provisions of the Act for the same or any other assessment year. The provisions in regard to audit of accounts relating to the qualifying expenditure and the continuance of the allowance in case of amalgamation are similar to those applicable for amortisation of preliminary expenses discussed earlier.

Other Deductions (Section 36) : This Section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditure are deductible are :

Insurance premia paid [*Clause* (*i*)] : If the insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

Insurance premia paid by a federal milk cooperative society [clause (ia)]. By virtue of the insertion of clause (ia) to Section 36 of the Income tax Act with effect from 1st April, 1980 deduction would also be allowed in respect of the amount of premium paid by a Federal Milk Cooperative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Cooperative Society. The deduction is admissible without any monetary or other limits.

Bonus and commission [*Clause* (*ii*)] : These are allowable subject to two conditions :

(a) The sum paid to the employee as bonus or commission should not be payable to him as profits or dividends, if it had not been paid as bonus or commission. This is a provision intended to safeguard against a private

company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members or employees of their own concern, instead of distributing the money as dividends or profits.

(b) The amount of bonus or commission must be reasonable having due regard to : (i) the pay of the employee and conditions of his service : (ii) the profits of the business for the year ; *and* (iii) the general practice in similar business.

By virtue of the Second Proviso to Section 36 (i) (ii) inserted by the Payment of Bonus (Amendment) Act, 1976 with effect from 1.4.1976, in the case of employees who are covered by the Payment of Bonus Act, 1965 the amount of bonus allowable as business expenditure in the assessment of the employer must be restricted to the sum payable under the amended provisions of the Payment of Bonus Act, 1965. The excess, if any, of the bonus paid by the emloyer over that ermissible under the Bonus Act must be disallowed in the assessment of the emloyer even though the total amount paid may be well within the limits specified in Section 40A (5). The excess cannot also be claimed as a deduction under Section 37(1). This aspect has been clarified by the CBDT also. For emloyees who are not covered by the Payment of Bonus Act, the actual ayment made by the employer would be allowed as a deduction under Section 36 (1) (ii) itself subject however to the limits specified in Section 40A (5).

Weighted deduction to employers employing blind or physically handicapped persons—Section 36(1) (iia).

In order to encourage employers to employ persons who are totally blind or physically handicapped, the Finance (No. 2) Act, 1980 has inserted a new clause (iia) in Section 36(1) to provide for a weighted deduction in an amount equal to one and one third times the salary paid to such persons. The weighted deduction will be admissible only in respect of employees whose income chargeable under the head "salaries" does not exceed Rs. 20,000 during the relevant previous year. For the purpose of this tax concession, "salary" will include the allowances, bonus or commission, whether payable monthly or otherwise. In order to qualify for this concession, the employer will have to produce before the Income-tax officer, in respect of the first assessment year for which deduction is claimed under the new provision, a certificate as to the total blindness of the employee from a registered oculist and in the case of an employee who is suffering from a permanent physical disability, a certificate from a registered medical practitioner, to the effect that the employee suffers from a permanent physical disability (other than blindness) which has the effect of reducing substantially his capacity to engage in a gainful employment or occupation. These provisions are similar to the provisions contained in Section 80U of the Income-tax Act.

This amendment will take effect from 1st April, 1981 and will accordingly apply in relation to the assessment year 1981-82 and subsequent years.

Interest on borrowed capital [*Clause* (*iii*)] : In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground

that the rate of interest is unreasonably high except in cases falling under Section 40A. The interest paid on capital borrowed for expanding a business is allowable under this clause although the assets brought into existence with the help of the borrowed capital had not been actually used for purpose of the business. But the amount allowable is limited only to interest; it does not include any bonus or premium paid on redemption of debentures. For the purpose of allowing the interest on borrowing it is immaterial whether the borrowed moneys are used for capital or revenue purposes and the assets acquired by the borrowings are brought into use during that year or not. For purpose of allowance the term 'interest' must be taken to have the same meaning as is given to it under the definition contained in Section 2 (28A).

This provision is subject, however, to the provision for disallowance of interest on deposits in the case of non-banking and non-financial companies under Section 40A (8).

Contributions to provident and other funds [Clause (iv) and (v)] : Contribution to the employees' provident and other funds are allowable subject to the following conditions :

(a) The fund should be settled upon a trust.

(b) In case of a Provident or a Superannuation or a Gratuity Fund, it should be the one recognised or approved under the Fourth Schedule to the Income-tax Act.

(c) The amount contributed should be periodic payment and not an *ad hoc* payment to start the fund.

(d) The fund should be for exclusive benefit of the *employees.*

The nature of the benefit available to the employees from the fund is not material : it may be pension, gratuity or provident fund.

Allowance for Animals [Clause (vi)] : This clause grants an allowance in respect of animals which have died or have become permanently useless. The amount of the allowance is the difference between the actual cost of the animal and the price realised on the sale of the animal itself or its carcasses. The allowance under this clause would thus recoup to the assessee the entire capital expenditure in respect of animals.

Bad debts [Clause (vii) and sub-section (2)] : These can be deducted subject to the following conditions :

(a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant accounting year.

(b) The debt should have been taken into account in computing the income of the assessee for the relevant accounting year or an earlier accounting year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

(c) The amount of the debt or loan, or part thereof which is claimed as deduction, should be established to have become bad during the accounting year.

(d) The amount should be written off as irrecoverable in the accounts of the assessee for that accounting year in which the claim for a deduction is made for the first time.

Further, if on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which the ultimate recovery out of the debt is made. It is, thus, permissible for the Income-Tax Officer to allow a deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is say, when the final result of the process of recovery comes to be known.

Furthermore, where any bad debt has been written off as irrecoverable in the accounts of the previous year and the Income Tax Officer is satisfied that such a debt or part thereof, in fact, had become a bad debt in any earlier previous year not falling beyond a period of four previous years, immediately preceding the previous year in which it is written off, the Income Tax Officer may rectify the assessment of the relevant previous year in which the debt should have been allowed provided the assessee accepts such a finding [Section 155 (6)].

Recovery of a Bad Debt Subsequently [*Section 41 (4)*] : If a deduction has been allowed in respect of a bad debt or part thereof under Section 36, and subsequently, the amount recovered in respect of such a debt or part thereof is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession, and accordingly will be charged to income-tax as the income of the previous year in which the amount is ultimately recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at that time.

Special Provision for Bad and Doubtful Debts in Cases of Rural Branches of Scheduled Banks : The Finance Act 1979 has inserted a new clause (viia) to sub-section (1) of Section 36 of the Income-tax Act with effect from 1st April, 1980 for the purpose of granting deduction in respect of any provision for bad and doubtful debts made by any scheduled or non-bank in relation to advances made by its rural branches. The amount of deduction shall not exceed 1½ per cent of the agreegate average advances made by such rural branches. The Central Board of Direct Taxes has been authorised to prescribe the rules to be followed for computation of the aggregate amount of average advances given by rural branches for the purpose of this deduction. The expression "*rural branch*" in this context must be taken to mean a branch of scheduled non scheduled bank situated in a place where the population was not more than 10,000 according to the last preceding census of which the relevant figures have been published before first day of the accounting year. The expression 'scheduled bank' should for this purpose be taken to refer the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the

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Reserve Bank of India Act, 1935. **The meaning of 'scheduled banks'** should however, be taken to exclude a co operative **bank in view of the express** provision made for this purpose by the Explanation to **Section 36 (1) (viia).** ***The*** *term 'non-scheduled bank' refers to a banking company as* ***defined in clause (c) of*** *Section 5 of the Banking Regulation Act 1949 which is* ***not a scheduled bank.***

Special Deduction: Financial Corporations ***Providing Long-term*** *Finance for Industrial or Agricultural Development [Clause (viii)]* **Under Section** *36 (1) (viii) of the Income-tax Act a special tax concession is* ***granted to financial*** *corporations providing long-term finance for the development* ***of industry and agriculture.*** *This provision is an exception to the general rule that no* ***deductions is admissible*** *in computing taxable profits in respect of any appropriation of* ***income*** *which the taxpayer may make out of his profits. It is only under this specific provision, financial corporations are permitted to appropriate their profits towards reserves with a view to augmenting their resources.*

Under this provision the deduction allowable to the corporation is calculated at a specified percentage of its total income (not necessarily the business income) as computed before making any deduction admissible to the corporation under Sections 80A to 80VV of the Income-tax Act. In the case of a financial corporation or a joint financial corporation established under the State Financial Corporations Act 1951 or an institution which is deemed under Section 46 of that Act to be a financial corporation established by any State Government for that State within the meaning of that Act, the amount of deduction admissible shall be 40 per cent of the total income of the corporation for the relevant assessment year which is carried out to a special reserve amount. In the case of any other financial corporation the amount admissible as deduction is 25 per cent of the total income of the financial corporation as computed in the manner mentioned above.

It is however essential that in both the cases the amount admissible as deduction should be carried to the reserve account of the financial corporation. In cases where the aggregate of the amounts carried to the reserve account of the corporation from time to time exceeds the paid up share capital (excluding the amounts captitalised from reserves) of the corporation, no further allowance would be admissible to the corporation in respect of any profits appropriated to the reserve in excess of the paid up share capital. Likewise, the deduction is admissible only so long as and, that too, to the extent to which the profits appropriated to the reserve account are equal to or less than the paid up share capital of the corporation. The allowance of this deduction is also subject to the further conditions that the financial corporation is for the the time being approved by the Central Government for purposes of his benefit.

With a view to enabling all approved financial corporations to build up resources at an accelerated speed the Finance Act, 1979 has amended Section 36 (1) (viii) with effect from 1st April, 1980 to secure that in the case of all financial corporation (other than the State Financial Corporation) the amount of deduction admissible under Section 36 (1) (viii) in respect of the profits appropriated to its

reserve shall be allowed at 40 per cent of such profits (as against 25 per upto 31st March, 1980). In the case of State Financial Corporation the limit corporation continues to remain at 25%.

Insertion of New Clause (viiia) by the Finance Act, 1982

Special Deduction for Scheduled Bank (Clause (viiia)]

With a view to provide an impetus to the expansion of banking operation outside India by Scheduled Banks being foreign banks) a special deduction is envisaged under the new clause (viiia) inserted by Finance Act 1982. This sub-section shall come into operation with effect from the assessment year 1983-84.

This new provision provides that a scheduled bank (other than a foreign bank) shall be allowed a deduction in respect of any special reserve up to a maximum of 40 percent of its total income (computed before making any deduction under Chapter VIA i.e., Sections 80A to 80VV). This deduction shall be allowed only in the case of a scheduled bank which is engaged in banking operations outside India and it is for the time being approved by the Central Government for the purpose of this clause. The Central Government shall grant approval to a scheduled bank having regard to the extent of its banking operations outside India, the need for resources for such operations outside India and any other relevant factor.

The term 'scheduled bank' here also should be taken to refer to the State Bank of India or any of its subsidiaries or any of the nationalised banks and to any other bank which is included in the Second Schedule to the Reserve Bank of India Act, 1934.

Expenses on Family Planning [Clause (ix)] : Any expenditure of revenue nature *bonafide* incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company's business income ; where, the expenditure is of a capital nature, one-fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. This deduction is allowable only to companies and not to other assessees. The assessees would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation without any time-limits. The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(Q) General Expenses (Section 37) :

Revenue Expenditure incurred for purposes of carrying on the Business, Profession or Vocation : This is a residuary Section under which only business expenditure is allowable but not the business losses, *e.g.*, those arising out of embezzlement, theft, destruction of assets, misappropriation by employees, *etc.* (These are allowable under Section 29, as losses incidental to the business). The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

Conditions for Allowance : The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this Section :

(a) The expenditure should not be of the nature described in Section 30 to 36 and Sections 37 (2), (2A), (2B) or (4), 40 and 40A.

(b) It should have been incurred by the assessee in the accounting year.

(c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.

(d) It must have been incurred after the business was set up.

(e) It should not be in the nature of any personnel expenses of the assessee.

(f) It should have been laid out or expended *wholly and exclusively* for the purpose of such business.

(g) It should not be in the nature of capital expenditure. (The principles to be followed for distinguishing capital expenditure from revenue are discussed below.)

(h) It should not be expenditure incurred in connection with income-tax proceeding for which deduction is allowable under Section 80 VV.

This Section is thus limited in scope. It does not permit an assessee to make all deduction which a prudent trader would make in ascertaining his own profit. It might be observed that the Section requires that the expenditure should be wholly, and exclusively, laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. Therefore, expenses wholly and exclusively, laid out for purposes of trade are, subject to the fulfilment of other conditions allowed under this Section even though the outlay is unnecessary or unnecessarily large in case of companies where, Section 40 (c) or 40A is applicable.

For determining whether, an expenditure is of the nature contemplated by the foregoing provisions of law the following tests should be applied :

(1) *'Character as a Trader'* : The expenditure should be incurred by the assessee in his character as a trader.

(2) *'Voluntarily Expended on Grounds of Commercial Expediency'* : A sum of money expended, not out of necessity but with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for purposes of the trade. (*Atherton Vs British Insulated and Helsby Ltd. 10 L.T.C. 155 (H.L.)*

(3) *'Direct Concern and Direct Purpose'* : In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business one must look to the direct concern and direct purpose for which the money is laid out and not the remote or indirect result which may possibly motivate or flow from the expenditure.

(4) *'Purpose of the Assessee's own Business'* : The expenditure should be primarily incurrred for the assessee's own business. Notwithstanding this proposition so long as the expenditure is for the whole and exclusive purpose of the assesee's trade the mere fact that the expenditure incidently obtains some advantage to the

assessee in some character other than that of a trader, would not detract the effect of the finding that the expenditure was wholly and exclusively incurred for purpose of the assessee's business.

(5) '*Unremuneratlve Expenditure*' : The expenditure need not be incurred solely for purpose of earning profit in the year of account. For example, the cost of repairs or advertisement or expenses on a foreign tour by the managing directors would be deductible even though the income therefrom would be earned in future years.

(6) '*Treatment in Assessee's Accounts*' : The way in which an item of expenditure is treated in the assessee's accounts is not a conclusive evidence against or in favour of the assessee.

Payments out of Profits and Payments Ascertained by Reference to Profits : When a trader makes a payment which is computed in relation to profits the question that arises is : Does the payment represent a mere division of profit with another person or is an item of exdenditure the amount of which is ascertained by reference to the profits ? The payment would be allowable in the second case but not in the first.

Distinction between Capital and Revenue Expenditure : The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of the expenditure is always a mixed question of law and fact. In deciding whether, an expenditure is of a revenue or a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the object for which the expenditure had been incurred. Whether, a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose one must look not to the documents but also the surrounding circumstances so as to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and then conclusions must be arrived at on the question whether, on a fair consideration of the whole situation as is evident from the facts the expenditure in question incurred in a particular case is of revenue nature or of a capital nature. The following broad principles have been evolved by the decisions of the various courts from time to time. These principles are neither exhaustive nor are they intended to be. They would serve only as guidelines to decide any problem arising in regard to the determination of the capital or revenue of a particular item [*Hylam Ltd vs. C.I.T. 1973 87 I.T.R. 310 (A.P.)*].

1. If the expenditure is for the initial outlay or for acquiring or bringing into existence any asset or advantage of an enduring benefit to the business of the assessee or from extension of the business which is already in existence or for substantial replacement of any existing business asset it must be treated as capital expenditure.

2. If, however, the expenditure, although incurred for the purpose of the business that too for acquiring an asset or advantage, for running the business or for working out that asset with a view to producing profits, it would be a revenue expenditure. Thus expenditure incurred for the purpose of carrying on the business

undertaking would be of a revenue nature. The expenditure which has to be incurred by an assessee in the ordinary course of his business, to enable him to carry on his trading operations is normally to be considered to be of a revenue nature. The expenditure incurred by the assessee cannot be considered to be capital in nature, merely because of the fact that the amount involved is large. The quantum of the expeniture cannot go to affect or alter the real nature and character of expenditure.

3. In cases, where the outgoing or money spent by the assessee is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit earning process of operations and not for the acquisition of any asset of a permanent character, the possession of which is a condition precedent to the running of the business, then, such an item of payment would constitute an.expenditure of a revenue nature.

4. Any special knowledge, technical know-how or patent or trade mark constitutes an asset and if such an asset is acquired for payment for its use and exploitation for a limited period in the business and the acquisition is not of an asset or advantage of an enduring nature and at the end of the stipulated period the asset or advantage reverts back in tact to the giver of the special knowledge or the owner of the patent, trade mark or copyright, it would constitute an expenditure of a revenue nature. In this context it may be noted that a payment made to ward off competition in business to a rival would constitute a capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time. The same result would not follow, if, there is no certainty of the duration of the advantage and the same can be put to an end at any point of time. How long the period of contemplated advantage or the benefit should be in order to constitute benefit of an enduring nature would depend upon the facts and circumstances of each individual case. Although enduring benefit need not be of an everlasting character, it should not be so transitory and ephemeral that it may be terminated at any time at the volition of any of the parties to the contract.

5. In cases of acquisition of a capital asset, it is immaterial whether, the price for it is paid by the assessee once and for all in lump-sum or periodically and also whether, it is paid out of capital or income or is linked with the total sales or the turnover of the business. In such a case the expenditure or outgoing would constitute payment of a capital nature, although it may indirectly be linked to or is paid out of revenue profit or sales.

6. In cases where, the amount paid for acquisition of an asset of an enduring nature is settled, by the mere fact that the amount so settled is chalked out into various small amounts or periodical instalments the capitai nature of the transaction or expenditure would not in any way be affected nor the fact that the payment is made in instalments or in small amounts would in any way alter the nature of the expenditure from capital to revenue. In other words, the magnitude of the payment and its periodicity would not be the deciding factors for determining the capital or revenue nature of any particular payment.

7. A lump sum amount paid for liquidating recurring claims would generally be of a revenue nature; it would not cease to be a revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. In such a case it is the intention and the object for which the assets are acquired that determine the nature of the expenditure incurred over it, and not the mode and the manner in which the payment is made nor is it in any way related to or determined by the source of such payment.

8. If, the expenditure in question is recurring and is incurred by the assessee during the ordinary course of the business or manufacture, it would normally constitute a revenue expenditure.

9. An asset or advantage of an enduring nature resulting in capital expenditure does not mean that such an asset should last for ever ; if the capital asset is, by its very nature, a short lived one, the expenditure incurred over it does not on that account cease to be a capital expenditure.

10. It is nowhere, stipulated in the law that if a benefit of enduring nature is obtained, the expenditure for securing it must always be treated as a capital expenditure. If the advantage or the benefit acquired by the assessee is to get the stock in trade of a business it would constitute a revenue expenditure ; but if what is acquired by the assessee is not the advantage of getting his current or trading assets directly but of something which has to be dressed up or processed before it is coverted into stock in trade, the expenditure incurred over it would constitute a capital expenditure.

11. Further, an item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or a capital asset ; it is a revenue expenditure when it is referable to circulating capital or stock in trade. Expenditure which relate to the framework of the taxpayer's business is a capital expenditure. Expenditure incurred for the termination of trading relationship in order to avoid losses occurring in future though that relationship whether, pecuniary loss or commercial inconvenience, is a revenue expenditure. Expenditure incurred for the initial starting of the business before its setting up or for substantial expansion and also expenditure incurred after the discontinuance of the business would be of a capital nature.

The capital revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The fact that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of accounts or other documents would not always be indicative or conclusive, as to what the real nature of the transaction is. Based upon the above principles the capital or revenue character of a particular expenditure will have to be decided in every case.

Miscellaneous Instances of Revenue Expenditure : Payment made for the use of goodwill, use of quota rights or in the case of a hotel or restaurant business the cost of table linen, crockery, pots is of a revenue expenditure. The cost of dredging

carried on by a harbour authority for the purpose of keeping the channels clear for shipping is also of revenue expenditure. Expenditure incurred by a surgeon or businessman on a study tour abroad to acquire knowledge of the latest techniques would be no revenue account.

Miscellaneous Instances of Capital Expenditure : Expenditure on improvement to property as distinguished from mere repairs or that which is incurred by a company in raising loans or issuing debentures for capital outlay would be capital expenditure if they are incurred before the business is set up. Legal expenses incurred in connection with the mortgage of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

For a detailed study of the case law on the question of allowability of expenses in different circumstances students are advised to refer to the discussion in the book of *M/s. Kanga and Palkhiwala* under Section 37 and the subsequent Income-Tax Reports with particular reference to Supreme Court Cases.

(R) Entertainment Expenses [Section 37(2A)]. The allowance in respect of entertainment expenditure incurred by an assessee, whether incurred *within or outside India* is regulated as per Section 37(2A). The deduction would be allowed in respect of the actual entertainment expenditure or an amount calculated at the following rates with reference to the profits and gains from business or profession, whatever is less :

(i) On the first Rs. 10,00,000 of the profits and gains	½% or Rs. 5,000 whichever is higher
(ii) On the next Rs. 40,00,000 of the profits and gains	¼%
(iii) On the next Rs. 1,20,00,000 of the profits and gains	⅛%
(iv) On the balance of the profits and gains	nil

Deductions applicable from 84-85 asst year

On the first Rs. 10,00,000 of the profits and gains	½% or Rs. 5000 whichever is higher
On the next Rs. 40,00,000 of the profits and gains	¼%
On the balance of profits and gains	⅛%

So, however, that the allowance shall in no case exceed Rs. 50,000.

For the purposes of allowing this deduction the profits and gains must be arrived at before allowing any deduction on account of development rebate, investment allowance or development allowance. In any case, the aforesaid limits would apply only if the actual expenditure is more than the amount specified in Section 37 (2A) ; if the actual expenditure is less than the limit mentioned above the deduction allowable to the assessee would be limited to the amount of actual expenditure.

For the purpose of this provision, the expression 'entertainment expenditure' includes.

(i) entertainment allowance paid to employees ;

(ii) expenditure in the nature of entertainment expenditure for the purpose of business or profession of the assessee incurred by any employee or other person

It may be noted that there are many judicial rulings to the effect that the ordinary elemantary extension of business courtesy or civility to visiting clients by

allowing them to quench their thirst, by offering the coffee, tea, *etc.*, cannot be understood to be expenditure in the nature of entertainment expenditure and will therefore have to be allowed under Section 37 (1).

However, the Finance Act, 1983 has added Explanation 2 to Section 37(2A) with retrospective effect from A.Y. 1976-77. It defines the term 'entertainment expenditure'. Accordingly it will include expenditure on provision of hospitality of every kind by the assessee to any person. This will include provision of food, beverages *etc.* whether under an express or implied contract, custom or usage of trade. This expenditure will not include expenditure on food, beverages *etc.* Provided by the assessee to his employees in office, factory, or other place of their work. The effect of this new provision will be that in respect of all assessee expenditure on tea, coffee, snacks, messing *etc.* provided to their customers will now be disallowable and proceedings will have to be started for reopening all completed assessments for A.Y. 1976-77 an onwards.

(S) **Advertisements in Souvenirs of Political Parties :** Sub-section (2B) of Section 37 disallows any deduction on account of advertisement expenses representing contributions made by and person carrying on business or profession in computing the profit and gains of the business or profession. It has specifically been provided that the new provision for disallowance would apply notwithstanding anything to the contrary contained in sub-section (1) of Section 37. In other words, the expenditure representing contribution for a political purposes would become disallowable even in these cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business. Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, tract or the like published by any political party, whether it is registered with Election Commission of India or not.

(T) **Expenditure on the Maintenance of Guest House** [Section 37 (3) and (4)]: With a view to placing an effective curb on lavish expenditure on maintenance of guest house, sub-section (4) provides that any expenditure incurred by an assessee on the maintenance of guest houses (other than holiday homes) *after 28-2-1970* shall be altogether disallowed in computing the income from business or profession. The disallowance will be not only of the establishment and other expenses for running the guest house but also the depreciation on the building where it is owned by the assessee and rent paid for the accommodation where, it has been taken on hire or lease. Depreciation on assets such as airconditioners, refrigerators, cooking ranges, furniture and fittings, *etc.*, in the guest house will also be disallowed. Where any charges are recovered from persons using the guest house, these will be deducted from the expenditure on the maintenance and depreciation and the balance will be disallowed. For this purpose, the accommodation hired or reserved by the assessee in a hotel for a period exceeding six months will also be treated as a guest house and the expenses incurred on its maintenance will be disallowed accordingly.

However, in the case of an assessee having in his employment not less than 100 wholetime employees throughout the relevant previous year, the expenditure

incurred on the maintenance of any "holiday home" exclusively for the use of his employees while on leave, will not be disallowed.

Advertisement, publicity, motor car and other expenses

The Finance Act, 1983, has inserted new sub-sections (3A) to (3D) to section 37. The provisions of these sub-sections are discussed below:

Where the expenditure or, as the case may be, the aggregate expenditure incurred by the assessee on any one or more of the items mentioned below, exceeds Rs. 1 lakh, 20% of such excess will be disallowed while computing the income from profits and gains of business or profession.

(a) **Advertisement, publicity and sales promotion**: The Act has not defined the term. Expenses relating to advertisement of goods, services etc. which form part of the business of the assessee, expenses on advertisement for staff recruitment, advertisments required to be given by law, etc. can be classified as advertisement expenses. However, it may be noted that recruitment advertisement etc, are made not with a view to promote sales.

The term 'Sales promotion' can have a wide meaning and may include almost all sales expenses including sales commission.

However, this will not include remuneration paid to employees of the assessee engaged in the above activities. Similarly, advertisement, publicity and sales promotion expenses incurred outside India by a domestic company or a resident assessee will not be subject to this disallowance.

(b) **Running and maintenance of aircraft and motor cars**: This will include expenditure incurred in chartering any aircraft and expenditure on hire charges for engaging cars plied for hire. Similarly, conveyance allowance paid to employees and directors will also be covered by this expenditure Motor car expenses incurred by a domestic company or a resident assessee at a branch office or an agency outside India will not suffer any disallowance under this section. It is for consideration whether normal tax charges and conveyance allowance to low paid employees for travel by local trains, buses, rickshaw, etc. will also be covered by this expenditure. Section 37 (3D) provides that the above provision for disallowance will not apply to assessess engaged in the business of operating aircraft and running motor cars on hire.

(c) **Payments made to hotels**: Payments made to hotels are subject to disallowance under section 37 (3A). There is no indication about the nature of payment. It appears that this refers to payments made to hotels for supply of boarding and lodging facilities, food, beverages etc.

Calculation: The aggregate amount of expenditure which is otherwise disallowable under any other provision of the Act, *e.g.* advertisement expenditure to be disallowed under Rule 6B, expenditure on motor car for personal uses, hotel bills for travelling in excess of limits provided in Rule 6D) will be first deducted. If the balance of the expenditure exceeds Rs. 1 lakh, 20% of such excess will be disallowed.

The provisions of section 37 (3A) provide for disallowance of expenditure which is otherwise allowable under section 37 of the I.T. Act. If any expenditure is allowable under any other section of the Income-tax Act, the same will be

allowed under that section and no portion of this expenditure can be considered for the purpose of disallowance under section 37 (3A). For example, repairs and insurance of motor car is allowable under section 31 of the I T. Act and therefore expenditure on repairs and insurance will not be considered as expenditure for running and maintenance of motor car under section 37 (3A). Similarly, depreciation on motor car will be fully allowed under section 32. Further, rent, rates, taxes, repairs and insurance of premises used for advertisement, publicity and sales promotion as allowable under section 30 and such expenditure will be outside the scope of section 37 (3A).

(U) Limitations on Advertisement Expenditure : Pursuant to Section 37 (3). Rule 6B has been introduced in the-Income-tax Rules to restrict expenditure on advertisement in the manner stated herainafter.

(a) In case of advertisement through presentation of articles, the valve of each such article should not exceed Rs. 50

(b) Advertisements outside India involving foreign exchange shouid be restricted to the extent of foreign exchange released by the Reserve Bank of India.

(c) The Income Tax Officer can disallow expenditure of advertisements which are not considered legitimate to the following cases :

(i) where the payment is made to a person who has a substantial interest in the business of the taxpayer or to a relative of such person : and

(ii) when the taxpayer has a substantial interest in the business of the adverts ising agent.

"Substantial interest" means a right to not less than 20% of the profit or beneficial ownership of not less than 20% of the equity capital.

In order to remove doubts the Finance Act, 1983, has inserted a new subsection (5) in section 37 with effect from A.Y. 1979-80. It clarifies that any accommodation maintained, hired, reserved or otherwise arranged by the assessee for providing boarding/lodging to any person will be regarded as guest house. It is also clarified that any such accommodation for use by employees/directors on tour or visit to the place where such accommodation is situated will be regarded as a guest house.

(W) Expenditure in Connection with Travelling, *etc.*: Under Rule 6D of the I.T. Rules the amount of expenses allowable in respect of travelling outside India by an employee of the assessee or any other person shall be limited to the aggregate amount of foreign exchange granted or permitted to the assessee for such a travel and the amount expended on such travel in terms of rupees. The amount allowable should be ascertained by dividing the actual number of days mainly devoted by the person outside India by the total number of days spent by him outside India, excluding, in both cases, the days taken for such travel by a reasonably direct route.

So far as travel within India, outside the headquarters is concerned, the expenditure allowable is limited to the aggregate of the following amounts :

(a) in respect of travel by rail, road, waterways or air, the expenditure actually incurred—

(b) in respect of any other expenditure including hotel expenses or allowances paid in connection with such travel—

(i) in the case of an employee whose salary is Rs. 1,000 *p.m.* or more	Rs. 150 per day or part thereof
(ii) in the case of any other employee	Rs. 75 per day or part there of
(iii) in the case of any other person.	Amount calculated on the basis of the amount applicable to the highest paid employee.

If the stay of the employee or other person outside his headquarters is in Bombay, Calcutta or Delhi the amount computed at the above rates can be increased by 33⅓% of such amount. However, if the employee or other person stays outside the headquarters, free of charge in a guest house maintained by the assessee the amount in that case shall be calculated at 1/3rd of the aforesaid rates and, where the employee or other person is provided free lodging, at 50% of the aforesaid rates.

(X) Limits of Reserve for Unexpired Risks : Under Rule 6E of the Income-tax Rules, in computing the income from any business of insurance other than life insurance the deduction in respect of the amount carried over to a reserve for unexpired risks including the amount of any additional reserve shall be restricted to : (a) in the case of a fire or miscellaneous insurance business—50% of the net premium income of the previous year ; (b) in the case of a marine insurance business 100% of the premium income of the previous year.

However, the amount of reserve of additional reserve disallowed under this provision in any year shall not be included in the total income in the next year for purpose of assessment. 'Net premium income' means the amount of premium received as reduced by the amount of reinsurance premium paid in respect of the relevant previous year.

1 5 Managing Ageney Commission (Section 39) : In case where a managing agent of a company was liable, under an agreement in writing made for adequate consideration, to share his managing agency commission with a third party, the managing agent was chargeable only on the share to which he was entitled under the third party being chargeable on his share under the agreement provided that the said agent and the third party had both held a declaration showing the proportion in which the commission is shared between them under the agreement and had proved to the satisfaction of the Income-tax Officer the facts contained in such a declaration.

1.6 Amounts not Deductible (Section 40) : By dividing the assessees into four distinct groups this Section places absolute restraint on the deductibility of certain expenses as follows :

(*a*) *In the case of any assessee*—

(i) Any interest payable outside India (not being interest on loan issued for public subscription before the 1st day of April, 1983) on which tax has not been

paid or deducted at source and in respect of which there is no person in India who may be treated as an agent under Section 163 :

(ii) any sum paid on account of tax or cess levied on profits on the basis of or proportion to the profits and gains of any business or profession :

(iii) any sum paid on account of wealth-tax.

For the purpose of this disallowance the expression *wealth-tax* means the wealth tax chargeable under the Wealth-tax Act, 1957, or any tax of a similar nature or character chargeable under any law in force in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in a business or profession carried on by the assessee, whether or not the debts of business or profession are allowed as a deduction in computing the amount with reference to which such tax is charged, but *does not include* any tax chargeable with reference to the value of any particular asset of the business or profession.

(iv) any sum which is chargeable under the head 'Salaries' if it is payable outside India and has not been paid or deductible at source therefrom under Chapter XVII-B of the Act ; and

(v) any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee had made effective arrangement make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head Salaries.

(b) *In the case of a firm—*

Any payment by way of interest, bonus, commission or remuneration but not rent made by the firm to any partner of the firm.

(c) *In the case of any company—*

Any expenditure which results directly or indirectly in the provision of any remuneration or benefit or amenity to a director (including an employee-director) or any other person who has a substantial interest in the company or to a relative of the director or of such person and

(ii) Any expenditure or allowance in respect of any asset of the company used by any person referred to in the foregoing sub-paragraph either wholly or partly for his own purposes or benefit.

The aforesaid payments would be disallowed if the Income-tax Officer considers that any such expenditure or allowance is excessive or unreasonable having due regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom. The deduction on account of such expenditure or allowance will be further subject to an overall ceiling limit of Rs 72,000 in respect of any director or person who has a substantial interest in the company or a relative of a director or of such person

Therefore, where the expenditure or allowance relates to a period exceeding eleven months comprised in the previous year, the maximum amount allowable shall not exceed Rs 72.000. But in cases where such expenditure or allowance relates to a period not exceeding eleven months comprised in the previous year, the maximum amount of allowance should be calculated at the rate of Rs. 6,000 for each month or part thereof comprised in that period. However, in cases where the director or

person having substantial interest in the company or a relative of either of them is also an employee of the company for any period comprised in the previous year the following items of expenditure shall not be taken into account for the purposes of disallowance under Section 40 (c) :

(i) the value of any travel concession or assistance and the value of any free or concessional passage qualifying for total exemption under Section 10 (5) and (6) (i) ;

(ii) any contribution by the employer to any recognised provident fund or to an approved superannuation fund or to an approved gratuity fund as referred to in Section 36 (1), (iv) and (v) ;

(iii) any expenditure incurred by the company for the purposes of promoting family planning specified in Section 36 (1) (ix).

It may, however, be noted that the amount of ceiling specified in Section 40 (c) only indicates the maximum amount allowable ; the amount of actual allowance may be even less than the limits prescribed.

(d) *In the case of a banking company* : The amounts which have been allowed as a deduction in computing its income chargeable to income-tax under the head "interest on securities" under Section 20 (1).

1.7 Expenses or Payments not Deductible in Certain Circumstances (Section 40A).

(*a*) *Payments to Relatives or Associates* : Sub section (2) of Section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or to an associate concern so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the I T.O. in computing the business income of the assessee. While considering whether a certain payment is excessive or unreasonable, I.T.O shall have due regard to :

(i) the market value of the goods, services or facilities for which the payment is made ; or

(ii) the legitimate needs of the business or profession carried on by the assessee : or

(iii) the benefit derived by or accruing to the assessee from such a payment.

The word "relative" as defined in Section 2(41) of the Act means, in relation to an individual, the spouse, brother or sister of any lineal ascendent or descendant of that individual. Where the assessee is a firm, H.U.F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and the members of the family or association. Similarly, where the assessee is a company the relationship will be reckoned with reference to the directors or persons having substantial interest in the company. The expression 'associate concern' means a concern which has a substantial interest in the business of the assessee or in which the assessee or any of his relatives has a substantial interest.

(b) *Cash payments in excess of Rs. 2,500* : According to Section 40A (3) all payments in excess of Rs. 2,500 claimed as deduction for computing business income

made otherwise than by a crossed cheque drawn on a bank or by a crossed bank-draft will be disallowed with effect from the assessment year 1968-69. If, in cases where such payments made otherwise than by crossed cheque or draft are allowed through oversight, otherwise the I.T.O. may disallow the same subsequently by re-opening the past assessment by treating it as a rectification of mistake under Section 154 (7). The operation of this provision can be relaxed at places where it could not be complied with due to the absence of banking facilities or under such circumstances as may be prescribed.

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income. It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding Rs. 2,500 at a time are required to be made by crossed bank cheques or drafts as interest is a deductible expenditure. This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by crossed cheque or draft apply equally to payments made for goods purchased on credit provided that the payment is made of an amount exceeding Rs, 2,500 at a time.

Rule 6DD of the Income-tax Rules permits, with effect from 1 4-1969, certain categories of payments under certain circumstances otherwise than by crossed cheque or draft. Accordingly, the provisions of Section 40A (3) do not apply to the cases and circumstances which are specified below.

(a) Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions including co-operative banks and land mortgage banks, primary credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institutions providing industrial finance.

(b) Payments which, under contracts entered into before 1-4-1969, have to be made only in cash.

(c) Payments made to the Central or State Government which, under the Rules framed by the Government, are required to be made in legal tender.

(d) Payments in village and towns having no banking facilities to persons ordinarily residing or carrying on business or profession in such villages or towns.

(e) Payments by way of book adjustments by the assessee in the account of the payee against moneys due to the tax-payer for any goods supplied or services rendered by him to the payee.

(f) Payments made by--

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank ; and

(iv) a bill of exchange made payable only to a bank.

(g) Payments of terminal benefits such as gratuity, retrenchment compensation *etc.*, to low paid employees (*i.e.*, those whose annual salary does not exceed Rs. 7,500) or to the members of their families.

(h) Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products including hides and skins, products of dairy or poultry farming, products of horticulture or agriculture, fish or fish products of any cottage industry run without the aid of power.

(i) In any other case, where the assessee satisfies the Income-tax Officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft either due to exceptional or unavoidable circumstances or because a payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee having due regard to the nature of the transaction and the necessity for an expeditious settlement thereof and also furnishes evidence to the satisfcation of the I.T.O as the genuineness of the payment and the identity of the payee.

(c) *Disallowance of managerial remuneration Section 40 A* (5). With a view to imposing restraints on business expenses so as to reduce income disparities sub-sections (5) and (6) placed certain ceiling limits on the deductible amount of expenditure that may be incurred by a tax payer on payment of salary to any employee or former employee (other than a director, in the case of a company) or in providing any perquisites *etc.*, to any such employee. According to the new provisions any expenditure incurred by an assessee on payment of salary to an employee will not be allowed as a deduction in computing the taxable profits to the extent it exceeds an amount calculated at the rate of Rs. 5,000 for each month or part thereof comprised in the period of employment of the employee in India. Similarly, expenditure incurred by the assessee on payment of salary to a former employee *i.e.*, an individual who ceases or has ceased to be the employee of the assessee during the previous year or any earlier previous year will not be allowed as a deduction in computing the taxable profits to the extent it exceeds Rs. 60,000 for the year.

In cases where the expenditure in respect of salary is incurred on payment of any remuneration to an employee or former employee engaged in scientific research during any of the three years immediately preceding the year of commencement of the business and such expenditure is deemed under the Explanation to Section 35(1) (i) to have been incurred in the previous year in which the business is commenced, the limit for disallowance of salary should be taken to be an amount calculated at the rate of Rs. 5,000 for each month or part thereof comprised in the

period of his employment in India during the previous year in which the business commenced and in the period of his employment in India during the three years immediately preceding that year.

For this purpose the expression 'salary' has been defined broadly on the lines of the provisions in Section 17 of the Act subject to certain modifications. The expression 'salary' will include wages, any annuity or pension, any gratuity, any fees or commission, profits in lieu of or in addition to salary or wages, any advance of salary and the annual accretion to the balance to the credit of an employee participating in a recognised provident fund to the extent it is chargeable to tax. It will not, however, include perquisites and the sums transferred from the account of the employee in an unrecognised provident fund to a recognised provident fund. In this context, the expression "profits in lieu of salary" will have the meaning as given in Section 17 (3) of the Act and will, therefore, include any compensation paid by the tax-payer to an employee or a former employee in connection with the termination of his employment or a modification of the terms and conditions relating thereto even if the compensation amount is exempt under Section 10 (10B) in the employee's hands.

Section 40 A (5) further imposes certain restriction on the deductible amount of expenditure which is incurred for providing any perquisites, whether convertible into money or not, to an employee or the amount of expenditure or allowance (such as depreciation allowance) in respect of assets used by an employee for his own purposes or benefit. The aggregate, of the expenditure or allowance in this regard that can be allowed as a deduction in computing the taxable profits will be limited to 20% of the amount of salary payable or an amount calculated at the rate of Rs. 1,000 for each month or part thereof comprised in the period of employment of the employee in India during the relevant accounting period, whichever is less.

For this purpose the expression '*perquisite*' has been defined to mean: (i) the value of any rent-free accommodation provided to the employee by the assessee; (ii) the value of any concession in the matter of rent in respect of any accommodation provided to the employee by the assessee; (iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate to the employee by the assessee; (iv) any sum paid by the assessee in respect of any obligation, which but for such payment, would have been payable by the employee; and (v) any sum paid by the assessee, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund, to effect an assurance on the life of an employee or to effect a contract for an annuity.

However, it has specially provided that the following items will *not* be taken into account in computing the expenditure or allowance that would not be deductible under the provision:—

(i) The value of any leave travel concession or assistance granted by the tax payer to his employee who is an Indian citizen and his or her spouse, children and dependents in connection with his proceeding to any place in India, whether on leave or after retirement from service, to the extent the amount thereof does not exceed the value of the travel concession or assistance which is exempt from tax in his hands under Section 10(5).

(ii) passage moneys or the value of any free or concessional passage granted by the tax payer to any employee who is not a citizen of India and his or her spouse and children in connection with his proceeding to his home country out of India, whether on leave or on retirement from service;

(iii) the employer's contribution to the employee's account in any recognised provident fund or an approved superannuation fund or for employee's benefit to an approved gratuity fund; and

(iv) where the tax payer is a company, any expenditure incurred by it for the purpose of promoting family planning amongst its employees.

The ceiling limit over the deductible amount of expenditure in respect of salary and perquistes *etc.*, will not, however be applicable in the following three cases *viz.*

(i) Payments to an employee in respect of a period of his employment outside India:

(ii) payments to a foreign technician who is entitled to exemption from tax his remuneration under Section 10(6) (vii) or (vii a) of the Act; and

(iii) payments to an employee whose income chargeable under the head "salaries" does not exceed Rs. 7,500 per annum.

Further, in order to prevent any circumventing of the new restriction aforesaid by converting 'contracts of service' into "contracts for service", sub-section (6) to Section 40A provides that the expenditure incurred by a tax-payer in payment of fees for services rendered by a person who at any time during the 25 months immediately preceding the relevant accounting year was his employee will not be allowed as a deduction in computing the taxable profits of the assessee also incurs in relation to such a person, any expenditure on payment of salary (*i. e.* pension *etc.*) the deduction in respect of the expenditure on payment of fees and that on payment of salary will be limited to Rs. 60,000 in the aggregate.

The provisions for disallowance of expenses or payments in all the above eases shall apply notwithstanding anything to the contrary contained in any other provision of the Act relating the computation of income from business of profession. Thus even if these items of expenses or payments are deductible under any other Section, the I.T.O. is entitled to disallow the same under this Section.

(*d*) *Disallowance of provision for gratuity* : Sub-section 40A (7) of the Income-tax Act, provides that no deduction would be allowable to any tax-payer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason. The reason for this disallowance is that under the provision of Section 36 (1) (v) of the Income-tax-Act deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a tax-payer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, Section 37 (1) provides that any expenditure other than the expenditure of the nature described in Sections 30 to 36 laid out or expen-

ded wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business. A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer. The new provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made under the provision of sub-section (7) of Section 40A in case where any provision is made by employer for the purpose of payment of a sum by way of *contribution to an approved gratuity fund during the previous year or* for the purpose of making *payment of any gratuity* that has become *payable during the previous year by* virtue of the employee's retirement, death, termination of service *etc.*

(e) *Disallowance of interest on deposits in the case of non-banking companies* : According to sub-section (8) to Section 40A, in all cases where the assessee is a company (other than a banking company or a financial company the meanings of which have been given below) and incurs any expenditure by way of interest in respect of any deposit received by it, 15% of such expenditure must be disallowed in computing the business income of the assessee for the relevant previous year.

For purposes of this allowance the expression "banking company" must be taken to mean a company to which the provision of the Banking Regulation Act, 1949 apply and to include any banking institution referred to in Section 51 of that Act.

The term "deposit" means any deposit of money with, and includes any money borrowed by a company. But the term "deposit" would *not*, however, include any amount received by the company.

(i) from the Central Government or any State Government or any local authority or from any other source where the repayment of the amount is guaranteed by the Central Government or a State Government ;

(ii) from the Government of a foreign State or any citizen from a foreign State or from any institution, association or body (whether incorporated or not established outside India :

(iii) as a loan from a banking company or from a co-operative society engaged in carrying on the business of banking (including a co operative land mortgage bank or a co-operative land development bank) ;

(iv) as a loan from any institution or a body specified in the list in the Tenth Schedule to the Income-tax Act or such other institution or body as the Central Government may, having due regard to the nature and objects of the institution or body, by notification in the Official Gazette specify in this behalf ;

(v) from any other company ;

(vi) from an employee of the company by way of security deposit ;

(vii) by way of security or as advance from any purchasing agent, selling agent or other agent in the course of or for the purpose of the business of company or as advance against orders for the supply of the services in the ordinary course of the business or profession carried on by the assessee ;

(viii) by way of subcription to any share, bond or debenture (such bond or debenture being secured by a charge or a lien on the assets of the company) pending the allotment of such share, stock, bond or debenture or by way of advance payment of any moneys uncalled and unpaid upon any shares in the company, if such moneys are not repayable in accordance with the articles of association of any company ;

(ix) as a loan from any person where the loan is secured by the creation of a mortgage, charge or pledge of any of the assets of the company (such loan being known as the relevant loan) and the amount of the relevant loan together with the amount of any other prior debt or loan secured by the creation of a mortgage, charge or pledge of such assets is not more than 75% of the price that such assets would ordinarily fetch on sale in the open market on that of the mortgage, charge or pledge for the relevant loan.

The expression, *financial campany*, has also been defined in the Explanation to mean :

(i) a hire purchase finance company, that is to say, a company which carries on as its principal business hire purchase transactions or the financing of such transactions ; or

(ii) an investment company, that is, a company which carries on as its principal business the acquisition of shares, stock, bonds, debentures, debenture stock or other securities issued by the Central Government, a State Government or a local authority or other marketable securities of a similar nature : or ;

(iii) a house financing company, that is, a company which carries on as its principal business the business of the acquisition or construction of houses including the acquisition or development of the land in connection therewith ;

(iv) a loan company, that is, a company which carries on as its principa business, the business of providing finance, whether by making loans or advances or otherwise (however, companies referred to in any of the first three bases mentioned above would not fall within the scope of meaning of the expression 'loan company') ;

(v) a mutual benefit finance company, that is, a company which carries on as its principal business the business of acceptance of deposits from its members and which is declared by the Central Government under the provisions of Section 120A of the Companies Act, 1956 to be a Nidhi or a mutual benefit society ; and

(vi) a miscellaneous finance company, that is, a company which carries on exclusively or almost exclusively two or more classes of business carried on in any of the preceding five cases.

1.8 Deduction in respect of Head Office Expenses, in the Case of Non-residents:— Section 44C restricts the scope of deduction available to non-residence taxpayers in the matter of allowance of head office expenses in computing their taxable income

from the business carried on in India. These restrictions would apply for the assessment year 1977-78 and subsequent years and would have the effect of overriding anything to the contrary contained in the provisions for allowance of expenses and other deductions contained in Sections 28 to 43 of the Income-tax Act which have already been discussed. The new provisions have prescribed the limits upto which the deduction could be allowed in computing profits and gains from any business carried on by the non-resident in India and apply to the expenses in the natter of head office expenses.

For the purpose of those restrictions and the consequent disallowance the expression '*head office expenditure*' must be taken to mean executive and general administration expenses incurred by the assessee outside India including also the expenditure incurred in respect of the following items *viz.*,

(i) rent, rates, taxes, repairs or insurance in respect of any premises outside India used for the purpose of the business or profession ;

(ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other persons employed in, or managing the affairs of any office in India ;

(iii) travelling expenses incurred in respect of any employee or other person who is employed in, or who is looking after the management of the affairs of any office outside India ; and

(iv) such other matters connected with executive and general administration of the business, as may be prescribed by the Central Board of Direct Taxes from time to time.

The *limits* prescribed under the new provisions are the following :

(i) an amount equal to 5% of the adjusted total income of the assessee ;

(ii) an amount equal to the average head office expenditure ;

(iii) an amount of so much of the expenditure in the nature of head office expenses (explained above), which are incurred by the assessee, as is attributable to the business or profession of the assessee in India. The limit upto which the deduction is permissible to the assessee is *the least* of the aforesaid three amounts and consequently, the basis for allowance would be the lowest of the above three items. If, however, the actual amount on account of head office expenses claimed by the assessee is less than the limits specified above, the deduction admissible would be confined to the amount of actual expenditure incurred by the assessee.

For the purpose of determining the amount of deduction admissible to the assessee, the expression *adjusted total income* used in item (i) above must be taken to mean the total income of the assessee computed in accordance with the provisions of the Income-tax Act *before giving effect* to the following items of allowance on deduction *viz.*

(a) depreciation allowance under Section 32 (2) ;

(b) investment allowance admissible under Section 32A ;

(c) development rebate allowable under Section 33 ;

(d) development allowance permissible under Section 33A ;

(e) capital expenditure or family planning incurred by companies admissible as a deduction under Section 36 (ix) ;

(f) any brought forward business loss qualifying for set off against business income in accordance with the provision of Section 72 (1) ;

(g) any brought forward loss in regard to any speculation business qualifying for set-off against income from speculation under Section 73 (2) ;

(h) any loss computed under the head 'capital gains' and brought forward from earlier assessment years qualifying for set-off under Section 74 (1) ; and

(i) any loss attributable to the casual items of income assessable under Section 56 qualifying for set-off in accordance with the provisions of Section 74A (3) ;

Thus the total income of the assessee computed for the relevant accounting year must be first ascertained before giving effect to the provisions for the aforesaid allowance are set-off and 5% thereof would be treated as the limit upto which head office expenses would be admissible as a deduction in computing the business of the non-resident for income-tax purposes.

The second limit for allowance is a sum equal to the average head office expenditure. For the purpose of determining this limit the expression '*average head office expenditure*' must be taken to mean—

(i) in cases where any expenditure in the nature of head office expenditure as mentioned earlier) has been allowed as a deduction in computing the business (income of the assessee chargeable to tax under the Income-tax Act in respect of each of the three accounting years relevant to the assessment years 1974-75, 1975-76, 1977-77—one third of the aggregate of the amount of the expenditure so allowed ;

(ii) in cases where the head office expenditure has been so allowed only in respect of two of the previous years relevant to the assessment years mentioned above—one half of the average amount of the expenditure so accrued to the assessee ;

(iii) in cases where the office expenditure has been so allowed only in respect of any one of three accounting years relevant to the assessment years mentioned earlier—the amount of expenditure actually allowed.

Thus, the average of the amounts previously allowed towards head office expenditure would be calculated and treated on the basis for determining the limits upto which the deduction towards head office expenditure would be admissible to the assessee in the assessment year 1977-78 or any subsequent year.

However, in cases where the adjusted total income of the assessee, 5% of which is to be taken as the basis for determining the first of the qualifying limits happens to be a loss the proviso to Section 44C authorises the limit of 5% to be taken with reference to the average adjusted total income of the assessee. Thus, in cases where the adjusted total income is a loss the assessee would be entitled to take the average of the adjusted total income of the three accounting years relevant to the concerned assessment years. For this purpose the expression '*average adjusted total income*' would mean—

(i) in cases where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year—one third of the aggregate amount of the adjusted total income of the accounting years relevant to the aforesaid three assessment years;

(ii) where the total income of the assessee is assessable only for two of the aforesaid three assessment years—one-half of the aggregate amount of the adjusted total income in respect of the two accounting years relevant to the aforesaid two assessment years ;

(iii) in cases where the total income of the assessee becomes assessable only for one of the three assessment years aforesaid—the amount of adjusted total income in respect of the accounting year relevant to that assessment year.

The aforesaid provisions of restricting all allowances on account of deduction in respect of head office expenditure would apply in the case of all non-resident tax-payers whose income from business or profession is chargeable to income tax under Section 21 of the Income-tax Act. The provisions for disallowance of the excess of the expenditure over the least of the limits mentioned above would apply even if the expenditure is such that it does not attract the provisions for disallowance contained in any other Section of the Income-tax Act.

1.9. Profits Chargeable to Tax (Section 41) : This Section enumerates certain receipts which are deemed to be income under the head "business or profession". Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this Section arises. The particulars of such receipts are given below :

(*1*) *Remission of Liability or Recoupment of Loss or Expenditure* : If any allowance is granted, in any year, in respect of any loss, expenditure or trading liability and subsequently, the same assessee receives, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure, or the assessee is granted a remission or an abatement in the trading liability, the amount received or that remitted or abated would be chargeable as business profit of the year in which the amount is received or the remission or an abatement is granted. It may be noted that the successor in business is not taxable in respect of the remission of liability allowed or expenditure incurred by the predecessors in the business or profession.

(*2*) *Balancing Charge* : If the assessee is able to recover more than the written down value, out of the moneys payable in respect of an asset, on adding thereto the amount of scrap value, if any, the excess amount recovered, upto the extent of total depreciation allowance granted in the past would be subject to tax. It is a balancing charge that ensures that the assessee would not receive by way of depreciation and sale proceeds of scrap an amount in excess of the actual cost of the asset. Such additions thus shall never exceed the amount of depreciation allowed on the assessee. This sub-section would apply even though the moneys are received after the business has ceased to exist provided that the moneys were due when the business was in existence. If the value of the asset has been fixed under

The section clarifies that irrespective of the previous year in which the liability is incurred according to the method of accounting regularly employed by the assessee, the deduction will be allowed in the year of actual payment. In view of this new provision, even if the deduction is otherwise allowable in a particular year in accordance with the well settled legal principles, it will not be allowed in that year but will be allowed only in the year of actual payment.

If deduction for any of the above expenditure has been allowed in the A.Y. 1983-84 or any earlier year on the ground that the same was incurred in that year, the assessee cannot claim deduction for the same in A.Y. 1984-85 or any later year when the actual payment is made.

1 12 Insurance Business (Section 44). This Section exempts an insurance business of any kind from the operation of the Section dealing with specified heads of income as well as those of Section 199 which deals with credits for tax deducted at source, to the extent to which the provisions of this Section are inconsistent with the Rules contained in the First Schedule to the Act, and provides that the profits and gains or such a business, from all sources, are to be computed notionally in accordance with these rules. The principle is applicable even to mutual associations and co-operative societies carrying on insurance business. For further details please refer to the First Schedule to the Income-tax Act.

1.13 Special Provisions in the case of certain Associations (Section 43A): This is a provision calculated to encourage the development activities carried on by trade, professional and other associations other than those whose incomes are already exempted under Section 10 (23A) This Section provides that where the expenditure incurred by an association solely for purposes of protection or advancement of the common interest of its members exceeds the amount collected by the association from the members whether by way of subscriction or otherwise, the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head "Profits and gains of business or profession", if there is no such income, then, it will be allowed as a deduction in computing the income under any other head. But only an amount upto 50% of total taxable income of the association can be set off against the deficiency aforementioned. In computing the taxable income of the association effect must first be given to the allowances or losses brought forward under any other Section of the Act. This Section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

1 14 Compulsory Maintenance of Accounts: Section 44AA provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Income-tax Officer to compute his total income in accordance with the provisions of the Income-tax Act. The payers carrying on these professions are statutorily obliged to maintain the prescribed books of account and other documents regardless of the quantum of their income and also regardless of the question

whether the profession was set up prior to or after the coming into force of this new provision.

Every taxpayer carrying on any business or profession (other than the profession specified above) must maintain the books of accounts prescribed by the Central Board of Direct Taxes in the following circumstances :

(a) in case where the income from the business or profession exceeds Rs. 25,000 or the total sales turnover or gross receipts, as the case may be, in the business or profession exceed or exceeds Rs. 2,50,000 in any one of the three years immediately preceding the accounting year : or

(b) in cases where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed Rs. 25,000 or his total sales turnover or gross receipts, as the case may be, in the business or profession are likely to exceed Rs, 2,50,000 during the previous year.

The Central Board of Direct Taxes has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained. Further, the Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Rules 6F of the Income-tax Rules contains the details relating to the books of accounts and other documents to be maintained by certain professionals under Section 44A.

1.15. Special Provisions for Computing the Profits and Gains of Shipping Business in csaes of Non-residents : (i) Section 44B provides for the computation of the profits and gains of the business of shipping carried on by non-residents to the extent they are chargeable to Income-tax in India. According to this, a sum equal to 7½% of the aggregate of the following amounts must be deemed to be the profits and gains of the business of shipping chargeable to tax under the head 'profits and gains of business or profession'.

(ii) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers livestock, mail or goods shipped at any port in India.

(iii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, live stock, mail or goods shipped at any port outside India.

The total of the above two amounts must be ascertained and 7½% thereof would be culculated and taken as the income from the business chargeable to tax in India. These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary

contained in the provisions of Sections 28 to 43A of the Income-tax Act. In other words, the income would be computed on this basis without applying the various provisions contained in Sections 28 to 43A. Consequential provisions are also seen in Section 172.

1.16 Computing Taxable Income by way of Royalties, ***etc.*****, in the case of Foreign Companies.** [Section 44D] This is a special provision for computing the income by way of royalties or fees for technical services chargeable to tax in the case of foreign companies. Accordingly, the income by way of royalties and fees for technical services must be computed on the basis of the provisions contained in Section 44D even if under the other provisions of the Act, computation would be made in a different manner. This provision would have the effect of superseding any other provision to the contrary containing in Sections 28 to 44 C.

The provisions apply to the computations of income by way of royalties or fees for technical know-how or technical services derived by and assessable in the hands of a foreign company. A foreign company for income-tax purposes is one which is not a domestic company. A domestic company is one which is either an Indian company or any other company which, in respect of its income chargeable to tax under the Income-tax Act, has made the prescribed arrangements for the declaration and payment, within India, of dividends, on preference shares payable out of the income taxable in India. Therefore, wherever there is a company which is not a domestic company within the meaning of the above expression it would be a foreign company and its income from royalties and fees for technical services must be computed in accordance with the new provisions.

The provisions have been enacted to ensure that the deductions admissible under Sections 28 to 44C of the Income-tax Act in computing the income by way of royalties or fees for technical services received from an Indian concern in pursuance of an agreement entered into by the foreign company with the Indian concerns before 1st April, 1976, must be limited in the aggregate to 20% of the gross amount of income by way of royalty or fees for technical services. In cases where the actual deductions in respect of expenses, *etc.*, admissible to the assessee under the provisions of Sections 28 to 44C are less than 20% of the gross amount of income, the deduction allowable is to be restricted to the actual expenditure or deduction otherwise permissible. For the purpose of restriction, the limit of 20% on the gross amount of income must be calculated on that portion of the gross amount of income as *reduced by* so much of the gross amount as consists of lump sum consideration for the transfer outside India or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, or trade mark or other similar property. Thus, the amount of lump sum consideration would be excluded from the gross amount of royalty income or fees for technical services for the purpose of determining the amount of deduction admissible to the assessee.

In cases where the income by way of royalties or fees for technical services is received by the foreign company from an Indian concern in pursuance of an agree-

ment made by the foreign company with the Indian concern on or after 1st April, 1976, the computation of taxable income would be made *without allowing any* deduction in respect of any expense or allowance under Section 28 to 44C. For this purpose the royalty income received by an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern after 31st March, 1976 must be deemed to have been received in pursuance of an agreement made before 1-4-1976 if such agreement is deemed for purpose of the Proviso to Section 9(I)(vi) as having been made before 1st April, 1976.

For the purpose of disallowance and also for the applicability of the concessional rates of tax on companies under Section 115A the expressions 'royalty', and 'fees for technical service' must be taken to have the same meaning as are given to them under Section 9(I) (vi) and (vii) explained in Study Paper I under the topic 'income deemed to accrue or arise in India'.

The Finance Act, 1983, has amended section 44D to provide that the restrictions on the deduction of expenses in computing, in the case of foreign companies, income by way of royalty or fees for technical services will also be applicable in cases where such income is received from Govt.

The above Act has also inserted a new clause (c) in Section 44D. Under this no deduction will be allowed in respect of any expenditure or allowance is computing, in the case of a foreiga company, income by way of interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency.

2. ASSESSMENT OF CAPITAL GAINS (Sections 45 to 55 A)

2.1 General (Section 45) ; Capital gains is the income by way of profits and gains arising from the transfer of a capital asset. The expression 'capital asset' [(Section 2 (14)], 'short term capital asset' [Section 2 (42A)] and transfer [Section 2 (47] have already been explained in Study Paper 1.

The Section applies not only to the transfer of a specified capital asset but also to a case where the whole of the business undertaking is sold. For the purpose of attracting liability to tax on capital gains it is not necessary that the assessee himself should voluntarily transfer the capital asset; even sale by a Commissioner or Receiver appointed by the Court in connection with any other proceeding under any law for the time being in force would be covered by this Section. A lease of mines or lands would amount to a transfer and consequently any premium paid for the lease may be assessable as capital gains. But a mere grant of the right of management of a cpital asset, not being a capital asset, would not, on its transfer give rise to capital gains.

In order to become taxable, the capital gains must have arisen to the assessee directly or indirectly as a result of the transfer on a capital asset. Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability the relavent date of the transfer is not the date of the agreement to sell but the actual date of sale i.e., the date on which the effective transfer of title to the property as (contemplated by the parties has taken place. [*Alapati Venkataramiah vs. C.I.T.*

1965) 67 I.T.R. 185 (S.C)]. Further, capital gains are taxable as the income of the year in which the transfer takes place, even though they may be realised later or there may be no realisation at all as a result of a variation agreed upon in a subsequent year (*T.V. Sundaram Iyenger & Sons vs. C.I.T. (1959)* 37 *I.T.R.* 29).

2.2. Calculation of the Period for which a Capital Asset is Held : In determining the period for which any capital asset is held by the assessee—

(a) in the case of a share held in a company under liquidation, the period subsequent to the date on which the company goes into liquidation shall not be counted.

(b) in the case of shares held in an amalgamated company in lieu of shares in the amalgamated company the period will count from the date of acquisition of shares in the amalgamating company ;

(c) in the case of a capital asset which becomes the property of the assessee in the circumstances mentioned in Clause (i) (v) of Section 49—(i) there shall be included the period for which the asset was held by the previous owner referred to in the said Section ; (ii) in respect of capital assets other than those mentioned in (i) above, the period for which any capital asset is held by the assessee shall be determined subject to any rules which the Board make in this behalf.

2.3 Capital Gains on Distribution of Assets by Companies in Liquidation (Section 46) : Where the assets of a Company are distributed to its share-holders on its liquidation, such a distribution is not to be regarded as a transfer of a capital asset by the company to its shareholders. This provision applies only to a distribution of capital assets *in specie* by a company in liquidation amongst its shareholders ; consequently capital gains made by liquidation of a company on sale of the company's assets with the object of distribution of the sales proceeds amongst the shareholders, must be assessed as the income of the company. However, a shareholder, on the liquidation of a company, receiving any money or other assets from the company shall be chargeable to tax on the income under the head 'capital gains' in respect of the excess over the cost so received in cash or the market value of the assets distributed in kind on the date of distribution as reduced by the amount assessed as dividend. When the shareholder subsequently sells the capital assets which he had received earlier from the company in liquidation he would be assessable on the excess of the sale price realised over the market value of the assets on the date of distribution [(Section 55 (2) (ii)] provided that he had already paid capital gains tax under this Section on the basis of their market value at the time of distribution.

If no capital gains tax had been assessed on the shareholder and he subsequently sells or otherwise transfers the capital assets received on the liquidation of the company, he is assessable on the basis of the cost for which the company had acquired the asset together with the cost of any improvement incurred by the company or the shareholder, as the case may be.

2.4. Transactions not regarded as transfer : (Section 47) : This Section enumerates nine circumstances in which the transfer of a capital as does not attract

liability to tax on the capital gains arising as a result of transfer. The exemption under this Section would apply to distribution of capital asset *in specie* but not to their sale with the object of distributing the sale proceeds. Consequently, capital gains made (i) by administrator on the sale of the testator's assets affected with a view to distributing the proceeds of sale amongst the legates as directed by the Will or (ii) by a Commissioner or Receiver appointed by the Court on the sale of the assets of dissolved firm would not be exempt from tax under this Section. But, in cases where, on the dissolution of a firm, one of the partners takes over the whole business and pays the other partners the value in money equivalent to his/their share in the assets, it would be considered to be a distribution *in specie* and would be entitled for the exemption under this Section. The adjustment of the rights of partners in a dissolved firm is neither a transfer nor is it for a price and consequently would not attract liability to tax on capital gains even in the absense of the provisions of Section 47 (ii).

The cases and circumstances specified as not being regarded at the transfer of a capital asset are as under.

(a) any distribution of capital assets on the total or partial partition of a Hindu undivided family.

(b) any distribution of capital assets on the dissolution of a firm, body of individual or other association of persons trust ;

(c) any transfer of a capital asset under a gift or will or an irrevocable ;

(d) any transfer of a capital asset by a holding company to its subsidiary company if (i) the parent company or its nominee holds the whole of the share capital of the subsidiary company ; *and* (ii) the subsidiary company is an Indian company ;

(e) any transfer of a capital asset by a subsidiary company to the holding company if :—

  (i) the whole of the share capital of the subsidiary company is held by the holding company ; *and*

  (ii) the holding company is an Indian company :

(f) any transfer, in a scheme of amalgamation as defined in Section (21A), of a capital asset by the amalgamating company to the amalgamated company provided that the amalgamated company is an Indian company;

(g) any transfer in a scheme of amalgamation by a shareholder of a eapital asset being a share or shares held by him in the amalgamating company *only if* ;

  (i) the transfer is made in consideration of the allotment to him of any shares in the amalgamated company ; and

  (ii) the amalgamated company is an Indian company.

(h) any transfer of agricultural land in India effected *before* 1-3-1970.

(i) any transfer of a capital asset by any assessee representing any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph, or print to the Government, or the National Museum or the National Art Gallery, National Archives or any such other

public museum, or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States.

2.5. Capital Gains on Sale of House Property Exempt from tax (Section 53) ; Capital gains arising from the transfer of one or more building and lands appurtenant thereto the income of which is chargeable under the head "income from house property" is exempt from tax subject to the following two conditions :

(a) the aggregate value of all consideration received for the sale of the property should not exceed Rs. 25,000 ; and

(b) the aggregate of the fair market value of such assets owned by the assessee before the above transfer should not exceed Rs. 50,000.

2.6. Capital Gains Sale of Residental House (Section 54) : Under the provisions of Section 54, as amended by the Finance Act, 1982, with effect from assessment year 1983-84, income by way of long term capital gains arising to an assessee from the transfer of capital asset would be exempt subject, however, to all the following conditions :

(i) The capital asset must be buildings or lands appurtement thereto and being a residential house.

(ii) The income (actual or deemed) derived from the property must be charge able to tax as "income from house property" under Section 23.

(iii) The capital gains derived on sale of the property should not be exempt under Section 53 stated above.

(iv) The assessee must have either constructed within a period of at least three years *after* the date of transfer or purchased within one year *before* or *after* that date a residential house property by utilising the capital gains.

The amendments made by the Finance Act, 1982 have liberalised the scheme of exemption on two accounts viz, (i) the house of transferred need not have been used for the purpose of the assessee's or his/her parent's residence alone. It can be a rented house also. The new residential house can be constructed within 3 years after the date of transfer as against 2 years earlier.

It is significant to note that the Section makes it specifically clear that the benefit of this exemption would be available only to *individuals*.

If all the above conditions are satisfied, then the capital gains will not be charged to tax as the income of the previous year in which the transfer took place ; instead, the capital gains shall be dealt with as under :

(i) If the amount of capital gains is greater than the cost of the new asset the difference between the amount of the capital gain and the cost of the new asset shall be taken as the income of the previous year. Thus if the amount of capital gain exceeds the amount reinvested, only the difference would be chargeable to tax as capital gains. But, if the house property so purchased or constructed is sold away within three years from the date of its purchase or completion of construction, as the case may be, the actual cost to the assessee shall be taken as *nil* and consequently the whole

amount received on the second transfer shall be taxable as capital gains.

(ii) If on the other hand the capital gain is equal to or less than the cost of the property, the cost of acquisition of the new house property if sold within the period of three years, shall be the actual cost *less* the amount of capital gain which was not taxed previously.

(iii) In all cases where the capital gain which was initially exempt becomes taxable in a subsequent year or where the capital gain which was taxable in an earlier year on its becoming due to the assessee gets exempt in a later year on the assessee complying with the provisions of this Section, the I.T.O shall make a reassessment in respect of the relevant previous year as if it were a case of rectification of mistake falling under Section 155 (8).

Whenever the residental house of the assessee is compulsorily acquired by the government and the amount of compensation is subsequently enhanced by any court or other authority, the amendments made with retrospective effect from 1-4-1974, would be of help to the assessee to claim additional exemption from tax on the additional capital gain under Section 54 and/or 54E. These details have been explained later.

2.7. Capital Gains on Transfer of Agricultural Lands Exempt from Tax in certain cases (Section 54 B). This Section provides exemption from tax on capital gains arising from the transfer of agricultural lands situated in municipal or other urban areas in certain cases.

In order to avail of this exemption (i) the capital assets being situated within the municipal or other urban areas must have been used by the assessee or his parents for agriculture purposes during the two years immediately preceding the date of its transfer, *and* (ii) the assessee must acquire, within a period of two years from the date of transfer, any other land in the same or other area for being used by him or his parents for agricultural purposes.

The exemption corresponds to the exemption in respect of capital gains arising from the transfer of residential houses available under section 54 and is intended to remove the hardship that may be caused to *bona fide* agriculturists who have to sell or otherwise transfer their agricultural land within such limits. The other provisions in this regard are similar to those discussed under Section 54.

In cases of compulsory acquisition of lands used for agricultural purposes by the Government and the compensation for the same is subsequently enhanced by the Court or other authority, in view of the amendments made by the Finance Act, 1978 with retrospective effect from 1-4-1974, the assessee would be entitled to claim additional exemption from tax in the manner explained later under Section 54D and/or 54E.

2.8 Capital Gains Arising on the Transfer by way of Compulsory Acquisition of Land and Buildings Exempt from Tax in certain cases (Section 54D). Section 54D provides relief from tax in the case of person owning industrial undertakings, in respect of capital gains arising on the compulsory acquisition, under any law, of any land or building used by them for the purposes of the business of the undertaking.

The relief under this Section will be available if the following conditions are satisfied:

(i) The capital gain should arise to the assessee on the transfer by way of compulsory acquisition of a capital asset, being land or building or any right in land or building forming part of an industrial undertaking belonging to him.

(ii) Such a capital asset must have been used by him for the purpose of the business of the said undertaking during the two years immediately preceding the date of transfer.

(iii) The assessee must, within a period of three years after that date, purchase any other land for building, or any right in any other land or building or construct any other building, or the purpose of shifting or re-establishing the said undertaking or setting up another industrial undertaking.

If the above conditions are satisfied the capital gain will not be charged to tax to the extent it is utilised for purchasing such land, building or any rights therein, as the case may be, or for constructing such building. Where the amount of the capital gain exceeds the cost of acquisition or construction, only the excess amount will be chargeable to tax. This concession will, however, be forfeited if the assessee transfers such new land or building within a period of three years from the date of its purchase or construction.

It must be noted that the relief under this Section will be available even if the assessee purchases or constructs the new asset after the completion of the assessment for the relevant assessment year, within the specified period of two years. In such cases, even though the capital gain will be included in the assessment of the assessee for the relevant assessment year, the I.T.O. will grant this relief subsequently by amending the assessment order [under Section 155 (10)] made by him so as to include the amount of the capital gain not chargeable to tax in accordance with the Section.

Wherever the compensation for the compulsory acquisition of the property is enhanced subsequently by the court or other appellate authority the assessee would be entitled to claim additional exemption from tax on capital gains by fulfilling the prescribed conditions under Section 54D and/or 54E. These have been explained later in this study.

2.9 **Long-term Capital Gains Exempt in certain cases:** (Section 54E): This section provides for an exemption in respect of capital gain arising from the transfer of a *long-term capital asset* in case where the whole or any part of the net *consideration* received or accruing from the transfer is invested or deposited by the tax-payer in specified financial assets within six months after the date of such transfer. For this purpose, the expression 'net consideration' in relation to the transfer of a capital asset would mean the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer. If only a part of the net consideration is invested then exemption would be available in respect of the proportionate part of the capital gains.

In respect of assets transferred after 28th February 1979, in order to enjoy the exemption under this provision, the net consideration resulting from the transfer or additional compensation or consideration should be invested in the 7 year National Rural Development Bonds, issued for this purpose. It may be noted that in respect of transfers effected before 1st March 1979, the law provided for investment in many other assets.

If the new (specified) asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the exemption granted under Section 54 E will be withdrawn. Section 54(E) (2) provides that the amount on which no capital gains tax was levied in the year in which the original asset was tranferred will be treated as long term capital gains of the year in which the new (specified) asset is transferred if such transfer is within 3 years.

If the period of six months for reinvestment has not ended before the date of completion of assessment and the assessee has made the investment in the specified asset after the assessment for the relevant year has been completed by the I.T.O. the exemption under Section 54E would be allowed by amending the assessment order made by him. Clause (10) of Section 155 provides for such amendment within 4 years from the date of the assessment order.

The new sub-sections (3), (4), (5) and 6 of Section 54E inserted by the Finance Act, 1978, provide that where a capital asset, not being a short-term capital asset, is transferred by way of compulsory acquisition or where the consideration for the transfer of the capital asset is determined or approved by the Central Government or the Reserve Bank of India and subsequently additional compensation is awarded by any Court, Tribunal or other authority, the capital gain attributable to such additional compensation would be exempt from tax, if such additional compensation is invested or deposited within the specified period in the specified asset referred to in Section 54E. The specified period for making the qualifying investment for purpose of exemption in relation to the capital gain attributable to such additional compensation will in such cases be determined with reference to the date of receipt to additional compensation by the taxpayer.

In such cases, if the regular assessment for the relevant year in which the capital asset was compulsorily acquired, had already been completed before the additional compensation is invested in the specified investments by the assessee the Income-tax Officer can amend the relevant assessment order under the new Section 155 (10 B) so as to exclude the relevant amount of capital gains in cases where the taxpayer has made the qualifying investment within the specified period.

It may be noted that the concession under Section 54E can be claimed only in respect of long term capital gains while the concession under Section 54, 54B 54D and 54F are available to both long-term and short-term capital gains. Similarly, the new Section 54E will also cover assets in respect of which Section 54, 54B, 54D and 54E are applicable but concession under the said Section are not available for any reason.

The provisions of Section 54, 54B, 54D and 54E not being mutually exclusive, a taxpayer be in a position to claim exemption from tax in respect of the transfer

of the very same capital asset both under Section 54 (or Section 54B and 54D, as the case may be) and under Section 54E. It must be noted that for the purpose of claiming exemption under Section 54, 54B and 54D it is enough if the assessee reinvests only the amount of capital gain for the acquisition of the house property, agricultural land or land and building for the setting up of an industrial undertaking, as the case may be. But in order to claim exemption from tax under Section 54E, the assessee should reinvest the full value of the consideration for the transfer of his capital asset so that entire amount of capital gains qualify for exemption under Section 54E. The time limit for investment is also different in all the four cases. The nature of the property to be acquired for claiming the exemption also varies under each of these Sections although a taxpayer, who is otherwise entitled to the exemption under Section 54, 54B and/or 54D, can also claim the exemption available under Section 54E by fulfilling the prescribed conditions for reinvestment within the time-limit of 6 months.

The Finance Act, 1983 has increased the scope for claiming exemption from tax on long-term capital gains by reinvestment of net consideration of a capital asset. In respect of assets sold/transferred on or a after 1-3-1983 the benefit of exemption can be claimed under Section 54E if reinvestment of net consideration is made within 6 months in any one or more of the following assets—

(a) Central Government securities which may be notified.
(b) Special series of Units of U.T.I. which the Government may notify.
(c) 7% National Rural development bonds or such other bonds as the Government may notify. Recently the Government has notified that National Rural Development Bonds (Second Issue) for this purpose.
(d) Debentures of Housing and Urban Development Corporation Ltd. as may be notified by the Government.

In order to get the benefit of the above exemption it is necessary that in respect of any sale/transfer on or after 1-3-1983 the assessee should reinvest the net consideration in any one or more of the above assets by way of initial subscription. He cannot purchase any of the above assets from any other person. It is also necessary that he has to retain the above assets for a period of 3 years. It is further provided that he cannot take a loan or advance on the security of any of the above assets during the above period. If any such loan/advance is taken the assessee will be deemed to have converted the above asset into money on that date and the exemption granted to the assessee under section 54E will be withdrawn.

Long-term capital gains exempt in cases of investment in residential houses: Amendments made by the Finance Act 1982

Insertion of new Section 54F by the Finance Act 1982 : With a view to encouraging house construction, a new Section 54F has been inserted by the Finance Act, 1982 which provides exemption of capital gains arising from the transfer of a long-term capital asset by an *individual* with effect from the assessment year 1983-84 subject to some conditions,

The capital gains arising to an assessee being an individual from the transfer of a long-term capital asset other than a residential house shall be exempt if the

assessee has purchased a residential house *within one year before or after* the date of transfer or has constructed a residential house within 3 years from the date of transfer. The entire capital gains shall be exempt if the cost of the residential house so purchased or constructed is not less than the net consideration in respect of the capital asset transferred. If the cost of the new asset is less than the net consideration in respect of the capital asset so transferred then the proportionate amount of capital gains as the cost of the new asset bears to the net consideration of the capital asset transferred shall be exempt. In this context net consideration means the full value of the capital asset as reduced by any expenditure wholly and exclusively incurred in connection with the transfer.

To claim exemption under Section 54F, the assessee has to satisfy the following conditions:—

(1) The assessee should not have owned any residential house on the date of transfer of capital asset.

(2) The assessee should neither purchase within one year before or after the date of transfer nor construct within three years after the date of transfer, any residential house other than the house which enabled him to claim the exemption under this provision.

If the assessee violates the second condition by purchasing any other residential house within one year after the date of transfer or by constructing any other residential house within three years after the date of transfer, the exemption granted under this Section shall be deemed to be the income chargeable to tax as long-term capital gains of the year of such purchase or construction.

(3) The assessee should not transfer the residential house which he purchased (in respect of which he availed exemption under Section 54F) within three years from the date of its purchase or construction.

If the assessee violates the above conditions then the amount of exemption he enjoyed under this Section in respect of the capital gains arising from the transfer of original asset shall be deemed to be the income of the assessee chargeable to tax as long-term capital gains of the year in which such house is transferred.

The provisions of Section 155 of the Income-tax Act have also been consequently amended with effect from 1st April, 1978 to insert a new sub-section (10A). The effect of the new provision is that in cases where, in the assessment for any year the capital gain arising from the transfer of long term capital asset is charged to tax and, within a period of six months from the date of transfer, the assessee has made the investment of deposit in any of the specified financial assets thereby being entitled to the benefit of exemption under Section 54E the amount of capital gain originally charged to tax would be subsequently exempted from tax by treating the case as one of mistakes from the record. For this purpose the Income-tax Officer is required to amend the order of assessment originally passed by him and pass a revised order of assessment granting exemption to the assessee. The time-limit of 4 years within which the order of rectification will have to be passed by the Income-tax Officer should for this purpose be reckoned from the date on which the order of assessment subjecting the capital gain to tax was passed by the Income-tax Officer originally.

2.11 Tax Exemption in cases of Enhancement of the Consideration by the Appellate Authority in respect of Capital Assets Compulsorily Acquired by the Government: The Finance Act, 1978 has amended Sections 54, 54B and 54D with restrospective effect from 1st April, 1974 to lay down specific provisions in these Sections to deal with cases where the capital asset in question has been transferred to the Central Government by virtue of its compulsory acquisition by the Government under any law for the time being in force and the amount of compensation originally awarded by the Government is disputed by assessee. Wherever there is enhancement of the compensation by the appellate authority and the assessee receives subsequent to the date of compulsory acquisition (sometimes many years later than the completion of acquisition proceedings) any additional amount of compensation, the amount of such additional compensation should be segregated between the interest for the period from the date of compulsory acquisition till the date of actual payment of the additional compensation and the principal amount representing the additional compensation itself. The interest would be taxable as 'income from other sources' and the principal i.e., the increase in the amount of compensation would represent income by way of capital gains.

Where there is enhancement of the compensation by the appellate authority the Income-tax Officer will be required to deal with the case as one of rectification of mistake apparent from the record and reopen the assessment if it had already been completed. The result of reopening the assessment would be that the income of the assessment year relevant to the provious year in which the capital gain attributable to the enhancement of compensation, (which ought to have been included in the total income if the enhanced compensation was originally awarded) and would be assessed to tax in the hands of the assessee. The assessee would, in the absence of any specific provisions for entitling him to make reinvestment and claim exemption from tax, be put to undue hardship by virtue of the enhancement and additional tax libility. With a view to removing the hardship which would otherwise be caused to the assessee, specific provisions have been inserted on identical basis in Sections 54, 54B, 54D and 54E. The result of the provisions in all these Sections is that the assessee is given the right to make the reinvestment in the specified type of capital asset within a period which is relevant for claiming exemption under the appropriate Sections from the date of actual receipt of the addtional compensation.

For instance, in the case of house property if the amount of additional compensation results in an increase in the amount of capital gain and the assessee's case is one which is governed by Section 54, the taxpayer would be entitled to make reinvesment of the amount of additional compensation and particularly the additional capital gain attributable thereto within a period of one year by purchasing or within two years by acquiring or within two years by constructing another house property for his own residence and the period of one year or two years, as the case may be, should be, reckoned from the date of receipt of the additional compensation from the Government. Similar is the scheme of exemption with reference to the period of acquisition of agricultural land under Section

54B to the extent of the additional capital gain arising from the enhancement of the compensation. Likewise, in cases where the business of an industrial undertaking owned by the assessee is compulsorily acquired by the Central Government and compensation become receivable by him in respect thereof the provisions of Section 54D permit the assessee to make reinvestment of the amount of additional compensation from the Government thereby entitling him to claim tax exemption in respect of such additional gains. Even in cases covered by Section 54D if the compensation is subsequently enhanced and the result of the enhancement is to increase the amount of capital gain assessable in the hands of the taxpayer, the taxpayer would under new provision be entitled to make a reinvestment with three years from the date of the receipt of the compensation. Under Section 54E also long-term capital assets which are compulsorily taken over by the Government would similarly entitle the assessee to claim the benefit of exemption if the amount of additional compensation is reinvested within six months from the date of its receipt in the specified financial asset.

The expression '*additional compensation*' referred to in this context must, in relation to the transfer of any capital asset by way of compulsory acquisition by the Government under any law for the time being in force, to be taken to mean the amount of the difference between the compensation for the acquisition of the asset as enhanced by the Court, Tribunal or other authority and the compensation which would have been paid if such enhancement had not been made. For instance, if for the takeover of a particular property the Government had originally given a compensation of Rs. 1,00,000 which, on appeal, is raised to Rs. 2,00,000 the amount of additional compensation would be Rs. 1,00,000. The capital gain attributable to the enhancement of compensation for the compulsory acquisition of any capital asset should be determined as follows :

(i) In case where the computation of capital gain under Section 48 by taking the compensation which would have been payable if such enhancement has not been made as the full value of the consideration for the transfer of the capital asset results in a loss or does not result in any profit or gain chargeable to income-tax under Section 45, the capital gain computed under Section 48 by taking the compensation as so enhanced as the full value of the consideration received or accruing as a result of the transfer would be the capital gain attributable to the enhancement. For instance, if in the above example, the cost of acquisition of the asset to the assessee was Rs. 1,00,000 the original compensation being also Rs. 1,00,000 there would have been no capital gain determined originally and the amount of capital gains as recomputed and as attributable to the enhancement of the compensation by the court would be Rs. 1,00,000. The same would have been the position even if the actual cost of the original capital asset compulsorily acquired by the Government was more than Rs. 1,00,000. In other words, the amount of additional compensation would in such cases be treated as the capital gain attributable the to the enhancement of compensation.

(ii) In any other case, the capital gain attributable to the enhancement of compensation would be the difference between (a) the capital gain computed under Section 48 before taking the compensation as so enhanced as the full value of the consideration so received or accruing; and (b) the capital gain computed under Section 48 by taking the compensation which would have been payable if such enhancement was not made as the full value of the consideration so received or accruing. For instance, if in the above example the original cost of acquisition of the asset was Rs. 80,000 and the compensation originally awarded Rs. 1,00,000 which had subsequently been raised to Rs. 2,00,000 on appeal, the capital gain originally computed would be Rs. 1,20,000 the amount of capital gain attributable to the enhancement of compensation being Rs. 1,00,000 i.e. Rs 1,20,000 – Rs. 20,000.

In cases where the property compulsorily acquired by the Government is a house property owned and used by the assessee or his parents mainly for his or their own residence and the unadjusted capital gain is utilised by the assessee within a period of one year before or after the date of receipt of the additional compensation for purchase of house property or the same may alternatively be utilised for construction of another house property for the purpose of assessee's own residence within two years from the date of its receipts. If the assessee complies with the condition for the reinvestment of the unadjusted capital gain as aforesaid and the amount of unadjusted capital gain is higher than the cost of the new asset the difference between the unadjusted capital gain and the cost of the new asset should be regarded as taxable by way of capital gain under Section 45 for the previous year in which the compulsory acquisition by the Government took place. In the event of the new asset being transferred by the assessee within a period of three years from the date of purchase or construction, as the case may be the cost thereof should be regarded as nil. If, on the other hand, the amount of unadjusted capital gain is equal to or less than the cost of the new asset the unadjusted capital gain would not be charged to tax. In case the new asset is transferred within a period of three years from the date of its purchase or construction, as the case may be, the cost of the new asset should be reduced by the amount of any unadjusted capital gain for determining the capital gain, if any, assessable to tax. Students are advised to go through the illustrations given in Sukumar Bhattacharya's book in this regard.

Similar determination of the capital gain with reference to the enhancement of compensation, unadjusted capital gain and the amount to be reinvested will have to be made in the cases and circumstances falling within the scope of sections 54B, 54D and 54E also. It must be noted that the nature of the capital asset sought to be covered for examination, the period for which the asset must be held the manner of transfer, the amount to be reinvested, the type of asset in which the reinvestment should be made and the period within which the reinvestment should be made would all be different in the different cases and one has to examine the facts of the case of the assessee and ascertain which of the Sections 54, 54B, 54D and 54E apply and the relevant provisions accordingly; It must, however, be noted that for

the purpose of exemption under Section 54E the assessee should reinvest in the specified manner the full amount of additional compensation to get the benefit of exemption from tax in respect of the unadjusted capital gain ; If the reinvestment is less than the additional compensation, the proportionate amount of unadjusted capital gain would alone be exempt thus making the remaining amount of the unadjusted capital gain taxable as long-term capital gains,

2.12. Computation of Capital Gains (Sections 48 to 52 and 55)

(a) *Method of Computation* (Section 48) : The income chargeable under the head 'capital gain' must be computed by deducting the following two items from the full value of the consideration received or receivable by or accruing to the assessee as a result of the transfer of the capital asset, *viz.*

(i) expenditure incurred by the assessee wholly and exclusively in connection with the transfer : *e.g.*, stamp duty, registration charges *etc.*, and ;

(ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

Capital gains should, like business income, be computed in accordance with the ordinary principles of commerical accounting as was held in *Miss Dhan Dadhabhoy Kapadia v. C.I.T. (1967) 63 I. T. R. 651 (SC).* For instance, while computing the capital gains on the sale of right shares the fall in the market value of the original shares subsequent upon the issue of right shares must be taken into account.

(b) *Cost of acquisition* : The expression "cost of acquisition" in relation to a capital asset has been defined in Section 55(2). According to the definition the meaning of the phrase is to be taken as under :

(i) Where the capital asset became the property of the assessee prior to 1-1-1964 the cost of acquisition shall be either the actual cost of its acquisition by the assessee or its fair market value as on 1-1-1964. whichever the assessee opts for.

(ii) Where the capital asset becomes the property of the assessee under any of the modes specified in Section 49(1) *i.e.*, succession, inheritance, devolution etc) and the capital asset was acquired by the previous owner prior to 1-1-1964 the cost of acquisition of the asset to the assessee shall be taken to be the actual cost of the capital asset to the previous owner or the fair market value of the asset as on 1-1-1964 *at the option of the assessee.*

However, where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner [Section 55 (3)].

(iii) Where the capital asset became the assessee's property on the distribution of capital assets of a company on its liquidation and the assessee has been assessed to tax under the head 'capital gains' in respect of that asset under Section 46, the cost acquisition to the assessee in such a case shall be taken to be the fair market value of the asset on the date of distribution by the company.

(iv) Where the captial asset being a share or stock of a company became the property of the assessee on—

(a) the consolidation and division of all or any of the share capital of the company into shares of a larger amount than its existing shares ;

(b) the conversion of any shares of the company into stock ;

(c) the conversion of any stock of the company into shares ;

(d) the sub-division of any of the shares of the company into shares of a small account ; or

(e) the conversion of one kind of shares of the company into another kind the cost of acquisition must be taken to be actual cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which the asset is derived by the assessee.

Transfer of capital assets which had no cost of acquisition to the assessee, no capital gain results :

Generally, only if an asset did cost something to the assessee in terms of money that the provisions relating to the levy of tax on any capital gains under Section 45 (i) read with section 48 (ii) would apply. All transactions encompassed by Section 45 (i) must fall under the governance of its computation provisions contained in section 48. A transaction to which those provisions cannot be applied must be regarded as never intended by Section 45 (i) to be the subject of the charge. What is contemplated by Section 48 (ii) is an asset in the acquisition of which it is possible to envisage a cost. N ne of the provisions pertaining to the head of "capital gains" suggests that these include an asset in the acquisition of which no cost at all can be conceived. (CIT v B.C. Srinivasa Setty (1981) 128 ITR 294, 299, 300 (SC.)

In this view of the matter, no capital gains tax is chargeable in respect of transfer of :—

1. Self-generated goodwill.
2. Import entitlements gained on exports.
3. Route permits for plying buses, etc.
4. Loom hours which did not cost anything.

(c) *Cost of Improvement* : According to Section 55 (1) (b), expression 'cost of any improvement' in relation to a capital asset has the following meanings :

(i) Where the capital asset becomes the property of the previous owner or of the assessee before 1-1-1964 and the fair market value of the asset on that date is taken as the cost of acquisition at the assessee's option the cost of any improvement to the asset means all the expenditure of a capital nature incurred in making any additions or alterations to the capital asset after 1-1-1964 by the previous owner or the assessee.

(ii) In any other case, the cost of any improvement to the assessee means all expenditure of a capital nature incurred in making any additions or alterations in the capital asset after it became his property or by the previous owner [if the asset became the property of the assessee by any of the modes specified in Section 49 (1)], as the case may be.

But the cost of improvement to a capital asset shall not include any expenditure which is deductible (whether actually deducted or not) in computing the income from interest on securities, income from house property, profits and gains of business or profession or income from other sources the expression "improvement" will have to be construed accordingly.

(d) *Cost with reference to certain modes of acquisition* [Section 49] : In cases where the capital assets became the property of the assessee—

(a) on any distribution of assets a total or partial partition of a H.U.F.;

(b) under a gift or a will or in case of conversion of the self-acquired property into the property of a H.U.F.;

(c) by succession, inheritance or devolution;

(d) or any distribution of assets on the dissolution of a firm, a body of individuals or other association of persons;

(e) on any distribution of assets of the liquidation of a company;

(f) under a transfer to a revocable or an irrevocable trust ;

(g) under any transfer by a holding company to its 100% subsidiary or *vice versa*; or

(h) under a scheme of amalgamation by the company to the amalgamated company;

then, the cost of acquisition of the assets must be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement to the assets incurred or borne by the previous owner or the assessee, as the case may be.

Where a capital asset became the property of the assessee on any distribution of assets on the total or partial partition of a H.U.F, or under a gift or a will or under succession, inheritance, devolution *etc.*, the cost of acquisition of the asset to previous owner of the property is the cost of acquisition to the latest previous owner who acquired the asset otherwise than by any of the modes of acquisition specified above.

In cases where the capital asset which was the self-acquired property of an individual converted into the property of a Hindu undivided family, the cost of the acquisition of the capital asset for the family must be deemed to be the cost of acqusition of that asset to the individual before the conversion took place.

Likewise, where a capital asset being a share in an amalgamated company became the property of the assessee in consideration of his transfer of a share or shares held by him in the amalgamating company under a scheme of amalgamation, the cost of aquisition to him of the shares in the amalgamated company must be taken to be the cost of aquisition to him of the share or shares in the amalgamating company.

Capital gains generally must be computed after deducting from the consideration the cost of acquistion to the assessee. The various provisions aforementioned from an exception to this general principle by providing that the cost to the previous owner shall be deemed to be the cost of acquisition to the assessee.

(e) *Special provisions for computing the cost of acquisition in the case of depreciable asset (Section 50)* : This Section provides another exception to the general rule

that capital gains must be computed after deducting from the sale price the cost of its acquisition. In the case of depreciable assets the written down value arrived at after deduction of all the depreciation (including initial depreciation) allowable *as adjusted* by the amount of terminal allowance or balance charge must be deemed to be the cost of acquisition. The adjustment must be with reference to the terminal depreciation actually allowed or the balancing charge actually levied and not merely the amount allowable. If however, for any reason, no balancing charge or depreciation is actually levied or allowed, then, the written down value shall be taken without any increase or diminution [Section 55 (1) (a)]. Further, where the fair market value of asset on 1-1-1964, is to be taken into account, at the option of the assessee, under Sections 49 and 55 (2), then the cost of the asset shall, at the option of the assessee be the fair market value af the asset on the said date *minus* the amount of depreciation, if any, allowed to the assessee after that date as adjusted.

In cases where the asset was on any previous occasion the subject matter o negotiations for transfer, any advance or other moneys received and retained by the assessee in respect of such negotiations should be deducted in computing the cost of its acquisition to the assessee [Section 51].

(f) *Consideration for transfer in cases of under-statement (Section 52)* : In cases where (i) the transferee is a person with whom the assessee is directly or indirectly connected and (ii) the I.T.O. has reason to believe that the transfer was effected with a view to avoiding a liability of the assessee to tax on the capital gains the full value of the consideration for the transfer shall be taken to be the fair market value of the capital asset on the date of the transfer. But before deciding the fair market value to be the full value of the consideration under this Section, he must get the prior approval of the Inspecting Assistant Commissioner.

However, if in the opinion of I.T.O., the fair market value of the capital asset on the date of the transfer exceeds the full value of the consideration declared by the assessee in respect of the transfer by not less than 15% of the value so declared, the full value of the consideration shall, with the prior approval of the I.A.C., be taken to be fair market value on the date of the transfer. The purpose of introducing these provisions is to provide an alternative means for ensuring that no avoidance of tax takes place; hence this Section provides for the revaluation of the asset by the I.T.O.

According to the the proviso to Section 52(2), the provisions of sub-section (2) of Section 52 for taking the fair market value of the property as the full value of the consideration for purposes of assessment to capital gains tax would *not* apply in following two cases :

(i) where the capital asset is transferred to the Government; or

(ii) where the full value of consideration for the transfer of the capital asset is determined or approved by the Central Government or the Reserve Bank of India and the adequacy of the full value of the consideration so determined or approved is not in any way questioned by the assessee.

The Supreme Court held in K.P. Varghese v I.T.O. (1981) 7 Taxman 13 (SC) that Section 52 (2) would apply only where the consideration for the transfer is

understated or where the assessee has actually received a larger consideration for the transfer than what is declared in the instrument of transfer and it would have no application to cases of bona-fide transaction where the full value of the consideration for the transfer is correctly declared by the assessee. In order to bring a case within Section 52(2), the revenue should show that not only the fair market value of the capital asset on the date of the transfer exceeds the full value of the consideration declared by the assessee by not less than 15% of the value so declared but also that the consideration has been understated and the assessee has actually received more than what is declared by him.

2.13 Reference to Valuers (Section 55A) : It provides that the I.T.O. may refer the valuation of the capital asset to Valuation Officer for the purpose of ascertaining the fair market value of a capital asset for the purpose of taxing capital gains. The reference could be made in cases where the value of the assests as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the I.T.O. is of the opinion that the value so claimed is less than its fair market value. In other cases the reference could be made if the I.T.O. is of the opinion that the fair market value of the asset exceeds the value of the asset claimed by more than such percentage of the value of the assets or by more than such amount as may be prescribed in this behalf. The reference could also be made in case where the I.T.O. is of the opinion that it is necessary to do so having due regard to the nature of the asset and other relevant circumstances.

2.14 Tax on Capital gains. The tax on long-term capital gains calculated (I) in the same way as any other income after making the deduction specified in Section 80T in the case of non-corporate assessee and (ii) at the rates specified in Seetion 115 in the case of companies, short-term capital gains are taxable in same way as any other items of income.

Fon assessees other than companies (Section 80T) : Where the gross total income of an assessee includes any income relating to long-term capital gains the following rules as to deduction shall apply :

(i) In a case where the long-term capital gains does not exceed Rs. 5,000 the whole of the long-term gain must be allowed as a deduction in computing the assessee's total income.

(ii) Thereafter, the deduction will be based on the number of years for which the relevant long-term capital asset has been held by the assessee. The rates of deduction have been specified in Twelfth Schedule which has been inserted by the Finance Act 1982. The following are the provisions in brief.

Period of holding capital assets	*Rate of deduction in respect of long-term capital gains relating to buildings or lands or any rights therein*	*Rate of deduction of long-term capital gains relating to other capital assets*
(1) Not less than 3 years but not exceeding 5 years	25%	40%
(2) Not less than 5 years but not exceeding 10 years	28%	45%

(3)	Not less than 10 years but not exceeding 15 years	33%	50%
(4)	Not less than 15 years but not exceeding 20 years	37%	55%
(5)	Over 20 years	40%	60%

(i) Where the long-term capital gains relate to gold, bullion or jewellery, the maximum deduction admissible will be restricted to Rs. 50,000.

(ii) Where the assessee has long-term capital gains relating to buildings or lands or rights in buildings or lands as also to other capital assets, the initial deduction of Rs. 5,000 will be given first in respect of long-term capital gains relating to buildings or lands or the right therein and if the amount of such capital gains is less than Rs. 5,000 the balance will be adjusted against long-term capital gains relating to gold, bullion or jewelley and the balance, if any, against the long-term capital gains relating to any other capital assets.

In the case of companies (Section 115): In this case the method of tax calculation to be followed is different. The amount of tax payable is first to be calculated on the total income excluding long-term capital gains *i.e.*, on the short-term capital gains together with the other incomes at the full rates applicable to them. The long-term capital gains are to be separately charged to tax at the rates given below :

(i) at 50% on capital gains arising from the transfer of land, buildings and any rights attached thereto ; however, in the case of a company in which the public are substantially interested whose total income (excluding long-term capital gains) does not exceed Rs. 1,00,000 the rate of tax on long-term capital gains attributable to lands and buildings or any rights therein would be 40% instead of 50%.

(ii) at 40% in the case of all other long-term capital gains.

A capital asset will be treated as long-term capital asset and consequently the gains arising on transfer of the asset would qualify for tax concession under Sections 80T and 115 only if the capital asset had been held by the assessee for not less than *thirty six months* immediately prior to the transfer. If the period of holding an asset by the assessee (and also the previous owners, wherever required) is less than thirty six months, the gain on the sale of asset would be short-term capital gain and taxable like any other income.

3. **INCOME FROM OTHER SOURCES** (Sections 56 to 59)

3.1. **General** (Section 56) : Any income, profits or gains included in the total income of an assessee, which cannot be included under any of the preceding five heads of income, is chargeable under the head "income from other sources." This head, thus is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. In consequence when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable to tax under the provisions of the Act it would be charged under this head.

Sub-section (2) specifically provides that (i) dividend income, (ii) casual income and (iii) income from the letting of machinery, plant or furniture belonging to the assessee when the letting of the building is inseparable from that of the plant, machinery and furniture shall be treated as income chargeable under this head [provided that the income in the third case is not otherwise taxable as income from business or profession] and shall be computed in accordance with the provision of Sections 57 and 58. The word 'dividend' as defined in Section 2(22) includes any 'dividend' declared, distributed or paid within the meaning of the definition (discussed in Study Paper 1) and will be deemed to be the income of the previous year in which these are declared, distributed or paid. Some of the other incomes that would be assessed under this head are director's fees, interest earned of any deposits including savings through an unrecognised provident fund, on loans on current accounts, or securities other than those to which Section 18 of the Act applies rent (other than rent of house property), royalties, fees, commission, examinership fees, honoraria for writing articles, papers *etc.*, tips, annuities and income includible in the assessee's total income under Sections 56 to 59.

Income from royalties and copyright fee for literary or artistic work are also chargeable under this head. Under Section 180 a relief has been granted to author of literary or artistic works by providing that the amount of taxable income in their hands can be allocated, at their option, over a period of three years in order that it may bear tax at a lower rate than the normal rate of tax which might be attached if the entire amount were to be charged as the income of a single year. Rule 9(2) of the Income-tax Rules, 1962 prescribes the mode of spreading the income covered by this Section over three years.

3.9. **Deduction Allowable** (Section 57) : The income chargeable under this head whatever be its source shall be computed after making allowance for any expenditure (not being in the nature of capital or personal expenditure) incurred during the accounting year solely for the purpose of making or earning such income. When the income chargeable under this head consists of dividends, the same shall be computed after making an allowance for any reasonable sum paid by way of commission or remuneration to a broker or any other person for collecting them on behalf of the assessee.

When the income falling to be charged under this head is derived from getting hire on any machinery, plant or furniture, the following items of deductions would also be made in the computation of such income :

(a) the amount paid on account of any current repairs to the machinery, plant or furniture [Section 30(a)(ii)].

(b) the amount of any premium paid in respect of insurance against risk of damage or destruction [Section 30(c)].

(c) the normal depreciation allowance in respect of the machinery, plant, or furniture and the "obsolescence", if any due thereon.

These allowances are to be regulated in accordance with provisions of Sections 30 (a), 30 (c), 31 and are subject to the provisions of Sections 34 and 38.

If it is found that for the purpose of earning the aforesaid income, it is inevitable for the assessee to let on hire some buildings, also, then, all the allowances enumerated above shall be made in respect of the buildings as well.

In computing the income under this head, deduction must be made in respect of expenditure incurred during the accounting year solely for the purpose of earning such income provided that the expenditure is not in the nature of a capital expenditure or personal expenses of the assessee. Expenses incurred for earning the income must be allowed as a deduction even in cases where the assessee has not derived any income from the concerned asset source during the relevant previous year. For instance, interest on moneys borrowed for investment in the shares would be deductible even if no dividends had been distributed in respect of those shares in the relevant previous year. [*C.I.T. v. Rajendra Prasad Moody (1978) 115 I.T.R. 519 (S.C.)*].

In view of the amendment to Section 57 made by the Finance Act, 1976 with effect from 1st June, 1976, the computation of 'income from other sources' in the case of *foreign companies*, for the assessment year 1977-78 and subsequennt years, must be made without allowing any deduction in respect of expenses by way of commission or remuneration paid or payable by the assessee for the purpose of realisation of the dividend income chargeable to tax under Section 56. Similarly, any other expenditure laid out or expended wholly and exclusively for the purpose of making or earning the income would not also be deductible in the case of foreign companies. The disallowance would operate in computing the income chargeable to tax by way of dividends in the case of all foreign companies with effect from 1st April, 1977. This disallowance corollary to the provisions of the Section 115A under which dividend income is chargeable to tax in the hands of foreign companies at concessional rates

3.3 Deductions not Allowable (Section 58) : No deduction shall be made in computing the 'income from other sources' of an assessee in respect of the following items of expenses :

(a) *In the case of all assessees—*

(i) any personal expenses of the assessee ;

(ii) any expenditure of a capital nature incurred by the assessee ;

(iii) any interest chargeable to tax under the Act which is payable outside India (other than interest on a loan issued for public subscription before 1-4-1938) an which tax has not been paid or deducted at source and in respect of which there is no person in India who may be treated as an agent under Section 163 for being assessed in his representative capacity;

(iv) any payment taxable in India as salaries if it is payable outside India unless tax has been paid thereon or deducted at source ; and

(v) any expenditure or allowance of the nature specified in Section 4C(a)(v) or 40A (5) [discussed earlier under the head "Income from business or profession or vocation"] irrespective of the fact whether or not the amount is included in the income and taxes in the hands of the employee.

(b) *In case of a company* the disallowance will, in addition to the above, be of any expenditure of the nature specified in Section 40(c) resulting in

the provision of any benefit, amenity or perquisite to a director or a person having substantial interest in the company or a relative of either of these two persons, which, in the opinion of the I.T.O., is excessive or unreasonable having regard to the legitimate business needs of the company and the benefit derived by or accruing to it therefrom.

In addition to these disallowances, sub-section (2) of Section 58 (with effect from 1-4-1968) specifically enacts that the provisions relating to the disallowance of payments to relatives and associate concerns, payment exceeding Rs. 2.500 made otherwise than by crossed cheques or drafts and ceiling on managerial remuneration in excess of Rs. 72,000 or Rs. 60,000 as the case may be, covered by Section 40A will be applicable to the computation of "income from other sources" as well.

According to Section 58(3) the provisions regarding the restriction for allowance of expenses contained in Section 44D applicable for the purpose of computing income from business or profession would similarly apply in the case of foreign companies to the extent to which they could be applied in computing their income chargeable to tax under the head "income from other sources". As the provision of Section 44D have already been explained, students may refer to the discussion".

3.4. Profits Chargeable to tax (Section 59) : The provisions of Section 41 (1) and (2) are made applicable, as far as possible, to the computation of income under this head also. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability, the recoupment of such loss or expenditure or the remission or cessation of the liability in the subsequent year shall be deemed to be the income of that latter year. Further, a balancing charge is leviable in respect of buildings, machinery, plant or furniture the rental income of which is assessable under Section 56 (2) (ii) as income under this head since the depreciation on these assets is allowable as deduction under Section 57 (ii). For a more detailed study on these topics students may refer to the discussion of the corresponding topics under the head 'Profits and gains of business or profession'.

4. SET OFF AND CARRY FORWARD OF LOSSES (Sections 70 to 80).

4.1. General. Since "Income tax" is only one tax and there are not as many taxes as there are heads of income" it is essential that a loss sustained in any year under one head of income should be set-off against the income under any other head in the same year in order to arrive at the true and correct total income of the assessee on which tax is payable. Even before ascertaining the amount of loss under one head, the assessee must deduct or set-off the losses incurred by him under the same head from the same source which are incidental to the business. Such a set-off of losses is also covered by the deductions allowable under the Act in respect of each head of income. In addition specific provision has been made for the set-off and carry forward of losses under different heads and different circumstances which are described in the following paragraphs.

4.2 Set-off of Losses against Income under the Same Head (Section 70): Under this Section the losses incurred by the assessee in respect of one source the income from which is taxable under the Act shall be set-off against income from any other source under the same head of income since the income under each head is to be

computed by lumping together the net result of the activities of all the sources covered by that head. Thus an assessee can set-off his business loss against income from profession or against income from any other business in the same year as all these sources of income fall under one head of Income. Therefore, the loss in one business may be set-off against the profits of the same year in another business even though the business in which the loss was incurred may have been carried on only for a short period during the accounting year and discontinued within the same year. The rule, however, is subject to three exceptions *viz.*

(i) A loss in speculation business can be set-off only against the profits of any other speculation business but not against any other business or professional income.

(ii) A loss in lotteries can be set-off only against income from lotteries but not against any other item of casual income. This principle would apply to all items of losses from sources the income of which is covered by Section 2(24) (ix)

(iii) A loss in respect of a long term capital asset can be set-off only against the income in respect of any other long-term capital asset.

These cases are discussed later in detail under their appropriate heads.

4.3. **Set-off of Losses Against Income Under any Other Head** (Section 71): After setting off the losses against income under the same head, if the net result is still a loss, the loss so computed under that head of income can be set-off against the income under any other head/s in the same year. Thus a business loss can be set off against income from house property or interest on securities or a loss under the head "income from other sources" can be set-off against business income or capital gains. The three exceptions specified in the preceding paragraph hold in this case also ; hence a long-term capital loss or a speculation loss cannot be set-off against income under any other head in the same year. A loss relating to short-term capital asset can be set off against income under any other head in the same year. However, if the loss relates to income assessable under any of the heads other than "capital gains", and the assessee has no income under the head 'capital gain', then he shall be entitled to have the amount of such loss set-off against income under any other head assessable for the same assessment year. In other words, if the assessee has income relating to capital gains (short-term or long-term) he can set off his loss under the other heads against the capital gains. The assessee is also given the option to set-off such losses (other than those relating to capital assets) only against short-term capital gains and income under any other head. Thus short term capital losses or gains have to be treated in the same way as any other income

4.4. **Carry Forward any Set off of Losses** (Section 72 and 80): Under the Act, the assessee has the right to carry forward the loss in cases where it cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set off against the profit of subsequent accounting year. The different items of losses which an assessee is entitled to carry forward relate to—

(i) unabsorbed depreciation ; (ii) unabsorbed development rebate ; (iii) unabsorbed development allowance ; (iv) unabsorbed capital expenditure on scientific

research ; (v) losses in speculation business ; (vi) losses in any other business or profession : (vii) losses under the head 'capital gains', and (viii) losses of a casual nature. The carry forward and set-off of unabsorbed depreciation, development rebate, development allowance and capital expenditure on scientific research are covered by their relevant Sections and have been discussed earlier at their appropriate places in this Study Paper.

This Section (*i.e.* Section 72) covers only the carry forward and set-off of losses arising from a business or profession. Therefore, the losses, if any, incurred by an assessee under the heads of 'income from house property', interst on securities", 'income from other sources' cannot be carried forward and set-off in the subsequent years under any circumstances. Carry forward under the head "capital gains" is governed by the provisions of Section 74.

The assessee's right to carry forward business losses under this Section, however is subject to the following conditions :—

(i) The loss should have been incurred in a business, profession or vocation.

(ii) The loss should not be in nature of a loss in the business of speculation which must be treated separately.

(iii) The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred. But a loss carried forward cannot, under any circumstances, be set-off against the income from any source other than a business or profession.

However, in cases where shares are held by an assessee as part of his stock-in-trade in his capacity as a dealer in shares, the dividends from those shares would form part of the income from business of the assessee although computed under the head, "income from other source" in view of the specific provision in Section 56 to that effect. Likewise, interest on securities which are held as stock in trade of the busineas of the assessee would constitute business income though it would be computed under the head "interest on securities." If the assessee, who is a dealer in shares has got brought forward losses in that business computed under the head profits and gains of business or profession', such losses could be set off in the subsequent eight years against the dividends from shares and the interest on securities which are held by him as his stock-in-trade. These principles have been laid down by the Supreme Court in the cases of *Western States Trading Co. (P). Ltd. v. C.I.T. (1971) 80 I.T.R. 21 and C.I.T. vs. Coconada Radhaswami Bank (1965) 57 I.T.R. 306.*

(iv) The business or profession in which the loss was incurred must continue to be carried on by the assessee in the previous year in which the loss is claimed to be set-off. In other words, the loss of a discontinued business cannot be carried forward or set off in any year later than the year of cessation of the business. But the profits of a discontinued business will however, be assessed as profits chargeable to tax under Section 41 (5).

(v) The loss can be carried forward and set-off only against the profits of assessee who incurred the loss. That is it is only the person who has

incurred the loss is who is entitled to carry forward or set-off the same. Consequently, the successor of a business cannot carry forward or set-off the losses of his predecessor except in the case of succession by inheritance. If the business remains the same and is carried on by the assessee under a separate or different ownership, such a separate ownership does not necessarily spell a separate business. [*Sitaram Jain v. C.I.T. 43 ITR 405*]. Generally an amalgamated company cannot carry forward the brought forward losses of the amalgamating company even if the amalgamation falls within the definition of the term given in Section 2(IA) ; however in the cases and circumstances specified in Section 72A with effect from 1-4-1978 the amalgamated company is entitled to claim the benefit of set-off of losses of the amalgamating company.

(vi) A business loss cannot be carried forward for a period which is more than *eight* years from the end of the previous year in which the loss was incurred.

(vii) In order to carry forward or set-off a loss the assessee must have filed a return of losses under Section 139 in accordance with the provisions of Section 80. In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the loss sustained by him. For this purpose it is immaterial whether the return of loss was filed voluntarily or after receiving a notice from the I.T.O. or after the prescribed time.

(viii) The assessee can carry forward only such an amount of loss as has been determined by the I.T.O. and disputed by him (*i.e.*, the assessee) he cannot claim to carry forward the entire amount of loss returned by him.

(ix) According to the Proviso to Section 72 (1) in the case of a business which is discontinued and subsequently received thereby entitling the assessee to deduction on account of rehabilitation allowance under Section 34B the provisions aforementioned relating to the continuance of the business and the period of carry forward of the loss will be relaxed by three years.

Sub-section (2) of Section 72 specifically provides that losses which have been carried forward from past years must first be set-off against business profits under this Section ; unabsorbed depreciation allowance of past years carried forward under Section 32 (2) should be set off only against the balance of such profits.

4.5 Carry forward and Set-off of Accumulated Business Losses and Unabsorbed Depreciation Allowance in certain cases of Amalgamation of Companies : According to Section 72A allowance and brought forward business losses of the amalgamating company would be admissible to the amalgamated company if the conditions specified in the new Section are fulfilled.

The new provision for carry forward and set off of unabsorbed depreciation and brought forward losses would apply only in those cases the amalgamation of such a company is recommended for this purpose by the specified authority in the Central Government by virtue of the fulfilment of all the following conditions :

(i) The amalgamating company, in the opinion of the specified authority, should not be financially viable by reason of its liabilities, losses and

other relevant factors. For this purpose, the financial viability of amalgamating company should be determined with reference to the financial position which existed immediately before the amalgamation took place.

(ii) The amalgamation, in the opinion of specified authority, should be in the public interest.

(iii) The amalgamating company should fulfil such other conditions as the Central Government may prescribe by notification in the Official Gazette with a view to ensuring that the benefit of set off under this new Section is restricted only to cases of those amalgamations which would facilitate the rehabilitation or revival of the business of the amalgamating company.

If the specified authority is satisfied in regard to the fulfilment of the aforesaid conditions, it may recommend the case to the Central Government which would thereafter make declaration to the effect that the amalgamated company would be entitled to set off against its income, the unabsorbed depreciation allowance and brought forward business losses of the amalgamating company. The declaration of the Central Government would in such case have effect notwithstanding the fact the provisions of the Income-tax Law relating to carry forward and set off of losses and depreciation do not otherwise permit such a set off. The effect of the Central Government's declaration would be that the accumulated losses and unabsorbed depreciation of the amalgamating company would be, by virtue of and from the date of the Central Government's order, deemed to be losses as the case may be, allowance towards depreciation of the amalgamated company for the previous year in which the amalgamation was effected. All the other provisions of the income-tax relating to the carry forward and set-off of losses and allowances for depreciation would accordingly apply to the amalgamated company as they would have applied to the amalgamating company if the amalgamation had not taken place.

The entitlement of the amalgamated company to the benefit of set off and carry forward of the accumulated losses and unabsorbed depreciation allowance of the amalgamating company is also subject to the fulfilment of the following further conditions by it, namely :

(i) The amalgamated company should, during the previous year relevant to the assessment year for which the set-off or allowance is claimed, continue to carry on the business of the amalgamating company without any modification or reorganisation or with such modification or re organisation as may be approved by the Central Government to enable the amalgamated company to carry on the business taken over by it more economically or more efficiently ; and

(ii) The amalgamated company should furnish along with its return of income for the relevant assessment year in which the set-off or allowance is claimed, a certificate from the specified authority to the effect that adequate steps have been taken by the amalgamated company for the

rehabilitation revival of the business of the amalgamating company ha been taken over by it.

For purposes of set off or carry forward or brought forward business losses and unabsorbed depreciation allowance the expression '*accumulated loss*' refers to so much of the loss of the amalgamating company computed under the Income-tax Act in accordance with the provisions of Section 28 to 44D under the head 'profits and gains of business or profession' which the amalgamating company would have been entitled to carry forward and set off under the provisions of Section 72 if the amalgamation had not taken place. However, losses incurred by the amalgamating company in its speculation business would not be entitled for the amalgamated company to carry forward or set off the same by virtue of the specific exclusion of speculation losses from the meaning of accumulated losses for the purposes of set-off. In view of the meaning of the expression 'accumulated loss' given in the Explantion to Section 72 A (2), the losses of amalgamating company incurred under the head 'capital gains', whether short-term or long-term, would not also qualify for being carried forward or set-off by the amalgamated company against its income under the head 'capital gains'. In other words, the benefit of carry forward and set off is limited to the amount or brought forward losses assessed under the head 'profits and gains of business or profession'.

The expression '*unabsorbed depreciation*' used in this context refers to so much of the allowance for depreciation of the amalgamating company which remains to be allowed to it under Section 32 of the Income-tax Act and which would have been allowed to the amalgamating company if the amalgamation had not taken place. Accordingly, any portion of the depreciation allowance which is disallowed by virtue of the specific provisions of the Income-tax Act [e.g, Sections 40A (5) and 38] would not entitle the amalgamated company to claim the same as unabsorbed depreciation in view of the fact that even the amalgamated company would not have been entitled to the allowance if the amalgamation had not taken place.

The expression '*specified authority*' means such authority as the Central Government may, by a notification in the Official Gazatte, specify for the purpose of Section 72. [refer to Notification No. 710 (E) dated 11-10-1977].

Sub-section (3) enables companies which go in for amalgamation to obtain an advance ruling from the specified authority in accordance with the entitlemens for the benefit of set off and carry forward of the brought forward business losses and unabsorbed depreciation allowance of the amalgamating company. The company is permitted (though not obliged) to submit the proposals of the scheme of amalgamation to the specified authority which would examine the scheme and take into account all the relevant facts to satisfy itself whether the conditions specified in Section 72A would be fulfilled if the amalgamation is effected in accordance with the scheme. The specific authority is also authorised to indicate such modifications in the proposals contained in the scheme of amalgamation as it may consider necessary. After examining the scheme and taken into account all the relevant facts and circumstances, if the specified authority is satisfied that the conditions

prescribed in Section 72A would be fulfilled if the amalgamation is effected in accordance with the scheme framed by the companies concerned or in accordance with the scheme as may be modified in the manner indicated by the specified authority, the specified authority may intimate the amalgamated company that, if the amalgamation takes place in accordance with the scheme approved by it, it would make a recommendation to the Central Government under Section 72A of the Income-tax Act unless there are any material changes in the relevant facts to the effect that the provisions of Section 72 may be invoked in its case. This scheme for advance ruling is the first of its kind under the Income-tax Law in India and would help the companies going in for amalgamation to obtain the tax benefit and particularly for ascertaining in advance whether the benefit of Section 72A would be available to it.

The entitlement of the amalgamated company to the benefit of set-off and carry forward of the accumulated losses and depreciation allowances of the amalgamating company is not a matter of right which automatically arises by virtue of the amalgamation. It is only in those cases where the Central Government is satisfied that the amalgamation is in the public interest and the specified authority recommends to the Central Government that the case is one where the provisions of Section 72A of the Income-tax Act may be made applicable, the question of claim by the amalgamated company in respect of these items of losses and depreciation allowance would become admissible. The decision of the Central Government which would be based upon the recommendation of the specified authority would be known to the amalgamated company at a point of time much later than the date of amalgamation. As a result there may be cases where an assessee company may merge with another company with the hope that the benefit of Section 72A may be available to it but it may be later on found that such a benefit is not available by virtue of the Central Government's refusal to issue a direction entitling the amalgamated company to claim the set off and carry forward of the accumulated losses and depreciation allowances of the amalgamated company.

Except in cases where the advance ruling of the specified authority is sought the elgibility for the benefit of set off is not known at the time of finalisation of the scheme of amalgamation or even at a time when the amalgamation actually takes place and there would be uncertainty over the entitlement of the amalganted company to claim this benefit. Since no time limit has been specified or prescribed either for the specified authority to make a recommendation or for the Central Government to issue a direction, the uncertainty in the matter of claiming the benefit of set-off under Section 72A may prevail for a long period. The Section does not also provide any right of appeal to the amalgamated company to any appellate or other authority against the order of the Government or specified authority if the Government does not issue a direction favourable to the assessee.

For the purpose of determining the financial viability of the amalgamating company immediately before its amalgamation, all the liabilities, losses and other relevant factors have to be taken into account by the specified authority. For this purpose even capital losses such as losses under the head 'capital gains' incurred by

the amalgamating company will have to be taken into account although such do not form part of the accumulated losses defined in the Explanation Section 72A (2). In other words, though the question of set off has to be coı ed only with reference to the accumulated brought forward losses attribut: the business of the amalgamating company and assessed by the Income-tax the financial viability of the company will have to be determined with ref also to its other losses including speculation losses, if any.

The time-limit for carry forward of the accumulated business losses is a of 8 years from the year in which the loss was incurred by the amalgamating pany. Therefore, the total period within which the set off of brought forward ness losses will have to be claimed by the amalgamating and the amalgmated pany is only 8 years. In other words, the limit for carry forward of business does not in any way get extended by virtue of the amalgamation. There is, hc no time limit for the carry forward and set off of the unabsorbed depreciation ance to which the amalgamating company was entitled. While the brought fc business losses of the amalgamating company can be set off by the amalga company, if directed by the Central Government to be entitled to make such off, only against the income by way of profits and gains from business com under the Income-tax Act in its hands subsequent to the amalgamation (w! from the same business or any other business) the unabsorbed depreciation ance can be set off by the amalgamated company against any income unde head without any time limit. The order of priority for carry forward and set business losses would, however, be the same as in the case of all taxp Accordingly, the forward business losses would be set off in preference t unabsorbed depreciation allowance.

4.6 Losses in Speculation Business (Section 73) : The meaning of the expr 'speculative transaction' as defined in Section 43 (5) and the assessability of in from speculation business have already been discussed under the head "profit gains of business or profession". Since speculation is deemed to be a bu. distinct and seperate from any other business carried on by the assessee, the l incurred in speculation can be neither set off in the same year against any othe speculation income for carried forward and set-off against profits in the subse years against such income. Therefore, the losses sustained by an assessee in a culation business, if the loss cannot be so set off in the same year, it can be ca forward to subsequent years and set off against income from any speculation ness carried on by the assessee. Similarly an assessee who incurred a loss business of speculation carried on by him individually is entitled to set it off a his share of the profits and another speculation business carried on by a fi which he is a partner. This Section thus provides an exception to the rule tha assessee must carry on the business in which the loss was originally incurred i year in respect of which the loss is claimed to be set-off. Like any other bus loss, the loss in speculation business can be carried forward only for a maxi period of eight years from the end of the relevant assessment year in respe which the loss was computed. The loss in speculation may also include the los

account of bad debts, irrecoverable profits and interest on borrowings. The other provision in relation to the carry forward of business losses will, as far as may be, apply to the losses in speculation business as well.

With a view to discouraging companies (other than banking and investment companies) from indulging in speculation business or dealing in shares otherwise than in the ordinary course of their business the Explanation to Section 73 provides that in cases where any part of the business of a company (other than investment company) consits of the purchase and sale of the shares of other companies such a company shall, for the purpose of set-off and carry forward of the losses incurred in such business, be deemed to carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares. However, companies engaged in the business of banking or the granting of loans and advances as their principal business would be exempted from the operation of this Explanation. Accordingly, both investment companies and banking companies would not be treated as carrying on speculation business in cases where they purchase and sell shares of other companies.

The effect of trading, non-banking or non-investment companies carrying on speculation business in regard to their transactions purchase and sale of shares of other companies is that the loss incurred by them in those transactions must be set off only against the income, if any, arising from similar transactions either in the same year or in the subsequent eight years. This is because of the fact that under the Income tax Law speculation business must be deemed to be a business distinct and separate from the other items of business carried on by the assessee and consequently the income or profit from this business must be accounted for separately and loss in speculation business would be allowed to be set off only against income from speculation. For this purpose, 'an investment company means a company whose gross total income consists mainly an income which is chargeable under the heads "interest on securities," "income from house property", capital gains" and "income from other sources".

4.7 Losses Under the Head "Capital Gains' (Section 74) : For all purposes of assessment and set off capital gains are classified into short-term and long-term (other) capital gains. The provisions in regard to the carry forward and set-off of losses ascertained under the head 'capital gains' are as under :—

Losses relating to short-term capital assets :

(i) A loss relating to short-term capital assets may be set off in the same year against capital gains attributable to any capital asset, whether short-term or long-term.

(ii) If it cannot be so set off, it can be set off against income under any other head in the same year.

(iii) Where the short-term capital loss cannot be set off in the same year wholly or in part, it can be carried forward for a maximum period of *eight* years and, set off against capital gains relating *only* to short-term capital assets (regardless of the amount of loss).

Losses relating to long-term capital assets :

(i) **A loss attributable to long-term capital** assets can be set off in the year *only* against long-term capital gains.

(ii) Under no circumstances can it be set-off *against 'short-term capital* gains' or other incomes including income from speculation.

(iii) A loss which cannot wholly or partly be set-off in the same year as aforesaid can be carried forward for a maximum period of *four* years and set off *only* against capital gains relating to long-term capital assets. According to the Proviso to Section 74 (i) (a) the right of any assessee (other than a company) to carry forward the net loss attributable to long-term capital assets in any year can be exercised only if the loss exceeds Rs. 5000. In other words non-corporate assessees cannot carry forward a long term capital loss if it is less tham Rs. 5,000.

4.8 Losses of a casual nature falling under the head 'Income from other sources' (Section 74A) : Section 74A provides that in cases where the net result of the computation made for any assessment year in respect of any of the following sources falling under the head 'income from other sources' is a loss, the loss so computed *shall not* be set-off against the income, if any from any other source under this head or any other head. The six sources the losses from which are to be taken into account for this purpose are :

(i) lotteries ;

(ii) cross-word puzzles ;

(iii) races including horse races ;

(iv) card games ;

(v) other games of any sort ;

(vi) gambling or betting of any form or nature whatsoever not covered by items (i) to (v).

For purposes of set off of losses each one of these sources must be deemed to be separate and distinct from one another : Consequently the loss from gambling, for instance, cannot be set off even in the same year, against income from lotteries or other items of casual incomes.

According to the provisions of sub-section (3) of Section 75A the losses, if any, incurred by an assessee in his activities of owning and maintaining racehorses which could not be set off against the income, if any, from race horses shall be carried forward for a maximum period of *four* assessment years for being set-off against his income from horse races in the subsequent four years. If however, the assessee does not have the activity of owning and running horse races during the year in respect of which the set-off is claimed, the assessee would not qualify for the set-off.

For this purpose, the "amount of loss incurred by the assessee in the activity of owning and maintaining race horses" means—

(i) in cases where the assessee has no income by way of stake money, the amount of revenue expenditure incurred by him wholly and exclusively for the purpose of maintaining the race horses ;

(ii) in cases where the assessee has income by way of stake money the amount by which such income falls short of the amount of revenue expenditure incurred by the assessee for the purpose of maintaining race horses.

Further, the expression *'race horse'* means a race horse upon which wagering or betting may be lawfully made.

It may be noted that losses incurred in respect of the other five sources of casual income cannot be carried forward.

4.9 Losses of Firms and their partners (Sections 75 to 78) : This topic has been discussed in detail in Study Paper IV under the heads, "set off and carry forward of losses in the case of firms and their partners and changes in the firms' constitution".

4.10 Carry Forward of Losses in cases of certain companies (Section 79) : This topic has been discussed in Study Paper V under the "Special provisions relating to taxation of companies".

SELF-EXAMINATION QUESTIONS

These questions are intended to enable the student to test his knowledge before proceeding to answer the test papers. The answers to these questions are not required to be written out and submitted for evaluation.

1. If the assessee's accounting period consists of 20 months for any particular assessment year and the amount of normal depreciation for a period of 12 months is Rs. 36,000 the normal depreciation allowable for the relevant assessment year is (a) Rs. 48,000, (b) Rs. 80,000, (c) 60,000, (b) Rs. 44,000.

2. Assets acquired for Rs. 750 or less in any year are allowed as a deduction full in the same year if they are (a) buildings (b) machinery or plant (c) furniture and fittings (d) patents and copyrights.

3. In order to qualify for initial depreciation allowance the building must be used for the welfare purposes of employees whose salary income is (a) Rs 10,000 p.a. or less (b) Rs. 18,000 p.a. or more (c) Rs. 12,000 p.a. (d) Rs. 30,000 p.a or more. ( )

4. The rate of initial depreciation in respect of buildings which are used (i) as hotels (ii) for the welfare of low paid employees is (a) 20% (b) 30% (c) 25% (d) 40% of the actual cost of building. ( )

5. The amount of extra depreciation available to hotels is (a) 25% (b) 50% (c) 20% (d) 60% of the normal depreciation for the relevant year. ( )

6. For purpose of allowing extra-shift allowance the total number of working days in any year shall be the actual number of days on which the factory has worked or (a) 270 (b) 300 (c) 180 (d) 250 days, whichever is greater.

7. Depreciation on imported motor cars will be allowed only (i) if they are used in the business of running it on hire for tourists (ii) if they are used by Ministers and Members of Parliament. ( )

8. If an asset whose cost of acquisition, W.D.V. and sale price are Rs. 50,000, Rs. 30,000 and Rs. 20,000 respectively there will be (a) terminal depreciation of Rs. 10,000 (b) balancing charge of Rs. 10,000 (c) normal depreciation of Rs. 23,000, (d) initial depreciation of Rs. 30,000 in the year of sale. ( )

9. Unabsorbed depreciation can be carried forward (a) for 9 years (b) 4 years (c) indefinitely without any time limit (b) for ten years)

10. Unabsorbed depreciation brought forward from earlier years can be set off in the subsequent years against (a) income from business or profession (b) income under any head (c) income from house property (d) capital gains (e) current depreciation. ( )

11. No development rebate is generally available in respect of ships acquired or machinery or plant installed by the tax payers at any time after (a) 1-3-1972 (b) 31-1-75 (c) 31-5-1974 (d) 1-4-1974. ( )

12. If a company following the calendar year as its accounting year acquired a ship for Rs. 40,00,000 on 30th December, 1978 and the ship was first put to use by the company only on 10th January, 1979 investment allowance allowable to the company is—(a) Rs. 10,00,000 in the accounting year 1979 (b) Rs. 10,00,000 in the accounting year 1981 (e) Rs. 12,00,000 for the assessment year 1982-83 (d) nil ( )

13. Unabsorbed/investment allowance can be carried forward for a maximum period of (a) 10 years (b) 6 years (c) 8 years (d) 4 years from the end of the accounting year in which the allowance was granted. ( )

14. Development allowance is granted in respect of actual cost of (a) acquiring plant or machinary, (b) planting or replanting tea bushes, (c) planting coffee and rubber plantations (d) planting medical drugs. ( )

15. Capital expenditure incurred by the assessee on scientific research will be deductible (a) over a period of 5 years one-fifth being allowable in each year (b) 50% in the relevant year and 50% in the next year, (c) in full in the same year, (d) as depreciation allowance by way of amortisation.

16. Unaborbed capital expenditure on scientific research relating to any year can be carried forward (a) indefinitely without any time limit (b) for 8 years (c) four years (d) ten years.

17. For purpose of amortisation the life of a patent or copyrights taken to be (a) 8 years (b) 5 years (d) 14 years.

18. If an approved export house spends Rs. 30,000 for developing export markets abroad it will be entitled to a deduction of (a) Rs. 60,000 (b) Rs. 80,000 (c) Rs. 30,000 (d) Rs. 40,000. ( )

19. A company will be entitled to the deduction on account of export markets development allowance only if the company is a (a) trading company (b) an investment company, (c) an industrial company, (d) a domestic company besides being the holder of an export house certificate, (e) a foreign company, (f) small scale exporter. ( )
20. Agriculture development allowance and rural development allowance are granted to (a) companies, (b) Indian companies, (c) domestic companies (d) agricultural trading companies, (e) industrial companies, (f) co-operative societies. ( )
21. If an assessee spends Rs. 30,000 for providing goods for or services to agriculturists the amount of deduction will be (a) Rs. 30,000 (b) Rs. 40,000 (c) Rs. 36,000 (d) Rs. 20,000. ( )
22. Contributions for rural development qualify for deduction to the extent of (a) 80% (b) 100% (c) 120% (d) 150%. ( )
23. The amount of preliminary expenses qualifying for amortisation should be restricted to (a) 20%, (b) 10%, (c) 8%, (d) 6%, (e) 5%, of the capital employed or the cost of the projects, whichever is higher ( )
24. If an assessee has paid bonus to his employees in 1980 for the year 1978 on the basis of an award of the Industrial Tribunal the amount of bonus is to be allowed as a deduction (a) for the year 1978 by reopening the assessment made earlier, (b) for the year 1980, (c) for the financial year 1980-81 (d) for the assessment year 1978-79.
25. The special deduction allowable to financial corporations providing long term finance for industrial or agricultural or housing development is subject to a limit of (a) 10%, (b) 15%, (c) 25%, (d) 40% of the total income. ( )
26. Expenditure on family planning amongst the employees will qualify for deduction while computing business income if the assessee is (a) company (b) individual (c) H.U.F., (d) firm ( )
27. Expenditure of capital nature incurred by an assessee for family planning amongst its employees will be deductible (a) in full in the same year (b) 1/5th (c) 1/6th (d) 1/10th in each year.
28. Subject to certain specified exceptions each payment will be disallowed in computing the business income of an assessee if it is in excess of (a) Rs. 1,000 (b) Rs. 2,250 (c) Rs 7,500 (d) Rs. 2,000 (e) Rs. 400. ( )
29. Expenditure incurred by an assessee in payment of salary to a former employee would be disallowed in computing the business income of the assessee to the extent it exceeds (a) Rs. 12,000 (b) Rs. 89,000 (c) Rs. 72,000 (d) Rs. 60,000 p. a.
30. The ceiling in respect of salary payable for services within India has, for purposes of deduction, been fixed at (a) Rs. 5,000 (b) Rs. 6,000 (c) Rs. 4,000 (d) Rs. 10,000 p.m. each employee ( )

31. Transfer of agricultural land in India would not be treated as a transfer of capital asset if it was effected (a) after 1-3-1970 (b) before 1-3-1970 (c) after 1-4-1971 (d) on or before 31-3-1978. ( )

32. The cost of acquisition of a capital asset in cases where the capital assets became the property of the assessee as a result of succession, inheritance, devolution etc., and the asset was acquired by the previous long back owner should be ascertained with reference to its market value on (a) 1-4-1961 (b) 1-4-1970 (c) 1-4-1954 (d) 1-4-1964 (e) 1-4-1955 ( )

33. A capital asset would be considered to be long-term capital asset if it was held by the assessee for (a) less than 90 months (b) more than 60 months (c) more than 36 months (d) 18 months (e) one year from 1-4-1977. ( )

34. Long-term capital gains included in the total income of a non-corporate assessee will be wholly exempt from tax if the assessee's total income does not exceed (a) Rs. 35,000 (b) 90,000 (c) Rs. 20,000 (d) Rs. 50,000 ( )

35. If a non-corporate assessee's total income exceeds Rs. 15,000, long-term capital gains included therein attributable to (i) land and buildings (ii) other assets will qualify for deduction at the rate of the first Rs. 5,000 plus (a) 35% (b) 45% (c) 40% (d) 50% (e) 65% (f) 30% (g) 25% of the balance. ( )

36. X, an individual, has a total income of Rs. 50,000 including Rs. 35,000 towards long-term capital gains on sale of his landed property. The assessee would qualify for a deduction from his gross total income of a sum equal to (a) Rs. 17,250 (b) Rs. 18,000 (c) Rs. 20,000 (d) Rs. 12,500. ( )

37. Y, a firm had a total income of Rs. 1,00,000 including Rs. 65,000 towards long-term capital gains attributable to investments in shares and securities. State the amount of deduction to which the firm will be entitled in the computation of its taxable income, (a) Rs. 29,000 (b) Rs. 27,000 (c) Rs. 21,000 (d) Rs. 32,500. ( )

38. X Co. (P) Ltd. has a total income of Rs. 2,20,000 including Rs. 1,20,000 toward long-term capital gains of which one-half is attributable to (i) land and buildings and (ii) the other half to investments in shares. State the rate/s of tax at which the company will be liable to pay tax on its capital gains (a) 45% (b) 65% (c) 50% (d) 30% (e) 55% (f) 40% (g) 47%. ( )

39. Interest on debentures owned by X's wife acquired out of a gift made to her by X out of his business profits and the capital gains made on their sale are includible in X's total income under Section 64. In X's return of income the interest and capital gains should be shown as (a) interest on securities (b) income from business (c) income from salaries (d) income from other sources (e) capital gains. ( )

40. Examinership fees received by X, Professor of Physics, Delhi University from the Madras University as a result of his position as the Professor of Physics is to be shown in his Income-tax returns as (a) income from salaries (b) income from other sources (c) income from profession (d) capital gains. ( )

41. Income from lotteries, horse races, betting and gambling received by a person who is regularly receiving these incomes and is engaged in these activities as his vocation should be taxed as his income from (a) shares (b) business (c) capital gains (d) house property ( )

42. Dividends from shares held as stock-in-trade of the assessee's business should be included in his total income as (a) income from business (b) interest on securities (c) income from profession (d) income from other sources. ( )

43. A loss under one head of income can generally be set off against income under any other head in the same year except in cases where the loss is from (a) profession (b) speculation business (c) short-term capital asset (d) long-term capital asset (e) other sources (f) business. ( )

44. The time limits for carry forward of unabsorbed (i) business losses [including speculation losses] (ii) short-term capital losses (iii) depreciation (iv) long-term capital loss (v) development rebate (vi) expenditure on scientific research (vii) loss from horse races are : (a) no time limit (b) cannot be carried forward (c) 4 years (d) 8 years (e) 6 years (f) 5 years, ( )

45. A brought forward business loss can be set-off against (a) salary income (b) dividends from shares and interest on securities which are held as stock-in-trade of the business (c) income from profession (d) income from lotteries (e) capital gains. ( )

46. A business loss cannot generally be carried forward after the business (a) has ceased to be carried on by the same assessee (b) has been sold to the competitors (c) has been amalgamated (d) has been succeeded to by the legal heirs.

47. A loss can generally be determined under the head income from house property. Such a loss (a) cannot be set off against any other income in the same year (b) can be carried forward for being set-off against rental income from house property in the next 8 years (e) can be set off against income under any other head in the same year (d) cannot be determined as a result of the allowance for newly built residential houses and unoccupied residential houses. ( )

48. Losses incurred by an individual in gambling could be set off against the income from (a) salaries (b) speculation business (c) capital gains (d) gambling (e) betting (f) lotteries. ( )

49. Losses in (i) lotteries, betting and gambling (ii) horse races would, to the extent these cannot be set-off in the same year, be (a) carried forward for 8 years (b) carried forward for four years (c) carried forward indefinitely and set off against income from the same source (d) lost once and for all since there is no right of carry forward. ( )

50. Losses incurred by an unregistered firm can be carried forward and set off by (a) the partners alone (b) the firm itself (c) the firm as well as the partners (d) the legal heirs of the partners ( )

51. Losses incurred by a registered firm can be carried forward and set off (a) by the firm alone (b) by the partners alone (c) by the firm and the partners (d) by the legal heirs and minors of the partners. ( )

52. Losses incurred by a company can be carried forward by (a) the shareholders (b) the board of directors (c) the persons having substantial interest in the company (d) company alone, ( )

53. In order to be entitled to carry forward the loss incurred in any year the assessee should have filed (a) an affidavit (b) a return of income (c) a return of loss (d) a partnership deed, (e) appeal. ( )

54. In the case of a company in which public are not substantially interested the brought forward loss of an earlier year can be set off against profits of a subsequent year only if not less than—of the shareholders who held the total voting power in the year in which the loss was incurred continue to hold at least—of the shares carrying voting rights in the year in which the loss is set-off (a) 40% (b) 51% (c) 40% (d) 60% (e) 100% 80%.

Answers:

1. [c], 2. [b], 3. [a], 4. [i] [c] [ii], [d] 5. [b], 6, [d], 7. [a], 8. [a], 9. [c], 10. [b], 11. [c], 12. [d], 13. [c], 14. [b], 15. [c], 16, [a], 17. [d], 18. [d], 19. [d], and [f], 20. [a], and [f] 21. [c], 22. [b], 23. [a], 24. [b], 25. [d], 26. [a], 27. [b]. 28. [b], 29. [d], 30. [a], 31. [b], 32. [d], 33. [c], 34. [b], 35. [i], [g], [ii] [c], 36. [d], 37. [a], 38. [i] [c] [ii] [f], 39. [d], 40. [b], 41. [d], 42. [d], 43. [b], and [d], 44. [i] [d], [ii] [d], [iii] [a], [iv] [c], [v] [d], [vi] [a], [vii] [c], 45. [b], 46. [a], 47. [c], and [d], 48. [d], 49. [i] [d], [ii], [b], 50. [b], 51. [b], 52. [d], 53. [c], 54. [b].

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The Institute of
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STUDY MATERIAL

F.S.P. I-Tax—4

FINAL COURSE

INCOME-TAX

STUDY—IV

Income-tax Administration and Assessment Procedure

Contents :

1. **Income Tax Authorities :**
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I. ADMINISTRATIVE SET-UP

Income-tax Authorities :

(i) **Appointment and control** (Sections 116 to 119) : These Sections relate to the income-tax authorities who exercise the powers under the Act ; these are both quasi-judicial and executive. Section 252 deals separately with the Appellate Tribunal which is not an income-tax administrative authority.

The seven income-tax authorities are :

(i) The Central Board of Direct Taxes ;
(ii) Directors of Inspection ;
(iii) Commissioners of Income-tax, Commissioners of Income-tax (Appeals) and Additional Commissioners of Income-tax ;
(iv) Appellate Assistant Commissioners of Income-tax ;
(v) Inspecting Assistant Commissioners of Income-tax ;
(vi) Income-tax Officers (Class I and Class II) ; and
(vii) Inspectors of Income-tax.

The Central Board of Direct Taxes is a statutory body constituted under the Central Boards of Revenue Act, 1963. It consists of a number of members appointed by the Central Government for the performance of such duties, as may be entrusted to the Board from time to time. At present, it is functioning as a Department of Revenue in the Ministry of Finance. The Central Board of Direct Taxes, besides being the highest executive authority, exercises control and supervision over all officers of the Income-tax Department and is authorised to exercise certain powers conferred upon it by the Income-tax Act. In particular, it has the power, subject to the control and approval of the Central Government to make any rules, at any time or from time to time for carrying out the purposes and implementing the provisions of the Income-tax Act.

All the rules under the Act, whether prescribed according to the appropriate Section in the Act or otherwise, are framed by the Board under Section 295 and placed before the Parliament. In addition to the general power of making rules and of superintendence, the Board has been given specific power on several matters the important ones of which are as under :

Section 2 (17) (18), (26)	—declaring an association to be a (a) company (b) company in which the public are substantially interested and (c) an Indian company for tax purposes.
Section (3) (1) (c)	—recognition of certain period as the previous year.
Section 32	—prescribing the rates of depreciation.
Section 35 D	—prescribing certain items of expenses as qualifying for amortisation

Section 44AA	—prescribing the books of accounts and documents to be maintained by tax-payers.
Section 107A	—granting reduction in the distributable income for purposes of additional income-tax.
Section 120 to 124	—regulating the jurisdiction of Directors of Inspection, Commissioners (Appeals), Commissioners, Appellate Assistant Commissioners, and Income-tax Officers.
Section 126	—entrusting the jurisdiction to special officer/s in certain cases.
Section 127	—transfer of cases.
Section 132 (10)	—prolonged detention of books in certain cases
Section 142 (2A)	—prescribing the requirements of Tax Audit.
Section 151	—sanction to issue notice in the case of belated or revised assessments.
Section 226 (2)	—collection of arrears of tax.
Section 228	—collection of tax through the Pakistan Revenue Board or on its behalf.
Section 288	—recognising certain accountancy examinations and hearing the appeal order disqualifying a person from appearing as an authorised representative.
Fourth Schedule	—regulating the investments of the money of provident funds, *etc.*

The Board has been empowered under Section 119 to issue instructions and circulars to its subordinates to regulate and administer the assessments under the Act. Accordingly, the Board can issue such orders, instructions and directions to the different income-tax authorities as it may deem fit for the proper administration of the Act. It is obligatory for the various authorities and all other persons employed in the execution of the Act to observe and follow such orders, instructions and directions of the Board. However, the Board is not empowered to issue orders, instructions or directions in such a way as to (i) require any income-tax authority to make the assessment of a particular case in a particular manner or (ii) interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions. Further, the Board may, if it considers necessary or expedient to do so, for the purpose of proper and effective management of the work of assessment and collection of revenue, issue general or special orders from time to time in respect to any class of incomes or class of cases setting forth directions and instructions (not being prejudicial to the assessee) as to the guidelines, principles or procedures to be followed by the income-tax authorities in the work relating to assessment or collection of revenue or the initiation of proceedings for imposing penalties. Any

such order may, if the Board is of the opinion that it is necessary in the public interest to do so, be published in the prescribed manner for general information. Also, the Board may, if it considers desirable or expedient to do so for avoiding genuine hardship in any case or classes of cases, by general or special order, authorise the Commissioner or the I.T.O. to admit an application or claim for any exemption, deduction, refund, or any other relief under the Act after the expiry of the period specified by or under the Act for making such application or claim and deal with the same on its merits in accordance with the law.

All the authorities except Class II Income-tax Officers and the Inspectors of Income-tax are appointed by the Central Government. The last mentioned classes of Officers are appointed by Commissioners.

The different echelons of authority mentioned below are directly appointed by the Central Government :

Directors of Inspection ;

Deputy Directors of Inspection ;

Assistant Directors of Inspection ;

Commissioners including Additional Commissioners of Income-tax and Commissioners (Appeals) ;

Inspecting Assistant Commissioners ;

Income-tax Officers, Class I and Class II.

The Appellate Assistant Commissioners of Income-tax and Commissioners (Appeals) are independent and are not subordinate to any of the authorities aforementioned in regard to their appellate functions. They are under the direct administrative control and supervision of the Central Board of Direct Taxes.

Importance of Income-tax Officer : The Income-tax Officer is the beginning in the hierarchy of the administrative set-up of the Income-tax Department. He initiates the assessment proceedings against every assessee calling upon him to submit a return of income, as well as to pay the tax which may be assessed on its basis. If the notice issued by him is not responded to in the manner required, the measures for the assessment and recovery of tax are set in motion. Again, where, any fraud is detected from the examination of the return he imposes a penalty. It would thus be evident that the Income-tax Officer is the most important person playing a distinctive role in the matter of administering the law relating to the levy and collection of taxes on income. The assessment order passed by him is final except in cases, where the assessee prefers an appeal against it or the Commissioner of Income-tax decides to revise it under Section 263 on the ground that it is erroneous insofar as it is prejudicial to interests of the Revenue. In respect of matters which may arise during the course of the assessment proceedings or which are connected with the levy and collection of taxes the Income-tax Act has vested in the Income-tax Officers wide

discretion. In many cases, the exercise of this discretion is almost unchallengeable.

(ii) **Jurisdiction** : (Sections 120 to 130 A) : The Central Board of Direct Taxes has an overall authority over all the income-tax authorities It determines the geographical areas of their jurisdiction and the class or classes of persons in respect of whom they shall exercise such a jurisdiction. For each State, a separate Commissioner of Income-tax is appointed by the Central Government but, if the State is large, more than one Commissioner may be appointed to perform such functions in respect of such areas and of such persons or classes of persons or such cases or incomes or classes of incomes or cases as the Central Board of Direct Taxes may direct. The Commissioner of Income-tax exercises administrative authority over the Income-tax Officers within his jurisdiction. The Directors of Inspection perform such functions as may be assigned to them by the Central Board of Direct Taxes especially to issue instructions and guidance to Inspecting Assistant Commissioners, Income-tax Officers, and other Officers subordinate to them. [Refer also to the discussion in study VII in regard to the creation of the new post of Commissioner (Appeals)].

Powers of Commissioner : The Commissioner has the power to allocate, distribute or re-allocate or re-distribute work between and amongst the Income-tax Officers under his jurisdiction. In the process, he can also re-allocate the work to another I.T.O. or transfer a class of cases or, even a particular case which is pending from one I.T.O. to another. The Commissioner also has the power to transfer any cases, whether pending or not, from one I.T.O. to another or from an I.T.O to an I.A.C.

Within the area assigned to him the I.T.O. has jurisdiction—

(i) in respect of any person carrying on a business or profession if the principal place of the business is situated within the area ; and

(ii) in respect of any person residing within the area.

The question of jurisdiction of an I.T.O. to assess any person cannot be the subject-matter of an appeal. It is only the Commissioner or the Board, and not the appellate authorities who can decide the question as to the jurisdiction of the I.T.O. in any case.

The I.T.O. can exercise his jurisdiction within particular geographical area only when he has been directed to perform his functions in respect of a specified area. Where the allocation of work is not with reference to any area but with reference to persons or classes of persons or incomes or clases of incomes or cases or classes of cases or where a case is assigned or transferred by the Commissioner or the Board, the I.T.O. can exercise his jurisdiction without reference to any particular area irrespective of the fact whether the assessee carries on business or resides within his jurisdiction. The [illegible]

partner takes no active part in the business of the firm and, for this purpose, the place of residence of the partner is immaterial.

Concurrent Jurisdiction of Income-tax Authorities :

The Commissioners of Income-tax have the jurisdiction to direct that two or more Income-tax Officers will exercise the concurrent jurisdiction in respect of the same area or the same persons or classes of persons, or the same incomes or classes of incomes, or the same eases or classes of cases ; under such directions, more than one Income-tax Officer should also be empowered to perform the same function in respect of the same case. These orders may be passed by the Commissioners or the Inspecting Assistant Commissioners for the purpose of facilitating the performance of such functions by the Income-tax Officers concerned. The object of this provision is to provide greater flexibility in the matter of distribution of work amongst the Income-tax Officers.

Section 125A, empowers the Commissioner of Income-tax to direct, by an order in writing, that all or any of the powers conferred on and functions assigned to the Income-tax Officer or Income-tax Officers (in cases where two or more Income-tax Officers exercise concurrent jurisdiction) will be exercised or performed concurrently by the Inspecting Assistant Commissioner. In that case the distribution of powers and functions in relation to the cases would be made by the Inspecting Assistant Commissioner between himself and the Income tax Officers working under him. Further, the Inspecting Assistant Commissioner would have the power to issue directions to the Income-tax Officers in individual cases subject, however, to the condition, that no directions prejudicial to the assessee would be issued without giving him an opportunity of being heard. For this purpose, instructions by the Inspecting Assistant Commissioner as to the lines on which investigations should be made in a case would not be regarded as instructions which are prejudicial to the assessee. Where the Inspecting Assistant Commissioner performs the functions of the Income-tax Officer no provision of the Income-tax Act requiring the approval or the sanction of the Inspecting Assistant Commissioner would apply, and, therefore, any appeal against the Inspecting Assistant Commissioner's order would lie direct to the Commissioner and therefrom to the Income-tax Appellate Tribunal.

The assessee can question the jurisdiction of an I.T.O. within the prescribed time limit but not later. The limit is (i) one month from the date of filing a return under Sectin 139(1) or completion of assessments, whichever is earlier, (ii) where the assessee has not filed a return, up to the time allowed for filing a return under Section 139 (2) and-or 148. The objection must reach the I.T.O. within the prescribed time. Where the question of jurisdiction is raised by the assessee on any ground and the I.T.O. disputes the assesee's claim, the I.T.O must refer the Commissioner for determination. If the question is one relating to areas, within the [illegible] Commissioners the question will have to be decided by all

the Commissioners concerned and, if they do not agree, by the Board. But in no case the I.T.O. has the power to decide or prejudge a question about his own jurisdiction. which is challenged by the assessee. The Act does not expressly provide that, while deciding about the jurisdiction of an I.T.O. the Commissioner or the Board should give the assessee a reasonable opportunity to represent his views.

Any order passed by an I.T.O. in respect of any assessment over which he does not have any jurisdiction is not merely invalid but also illegal. While exercising his jurisdiction, the I.T.O. must see that two assessments are not made at different places upon the same person in respect of the same income. This is essential particularly in cases where there are more Income-tax Officers than one appointed for the same area having concurrent jurisdiction. Where there are two or more Income-tax Officers having territorial jurisdiction in respect of the same income, they exercise concurrent jurisdiction in the matter of issuing notices to the assessee. Where notices have been issued by one Officer it is not necessary for the other Officer to issue the same notices again. However, where two Income-tax Officers have concurrent jurisdiction in respect of a particular case, a higher authority may decide as to which I.T.O. should perform a particular function or the case may be validly transferred from one to the other.

Functional Distribution and Allocation of work amongst Income-tax Authorities :

(i) A Commissioner of Income-tax is authorised to appoint, with reference to the same area or the same assessee, two or more Inspecting Assistant Commissioners or Income-tax Officers having jurisdiction concurrently in respect of that area or those assessees. The Officers so appointed shall exercise such functions in relation to the said areas or assessees as are specified by the Commissioner or the Inspecting Assistant Commissioner under his direction by a general or special order in writing for the allocation and distribution of the work to be per formed.

(ii) The Board or the Commissioner has the authority to transfer a case from the jurisdiction of one or more Income-tax Officer/s to that of another orothers.

(iii) The Commissioner of Income-tax is empowered to assign the responsibility for carrying out periodically, simple or minor functions *e.g.*, collection of advance tax, collection of tax in simple cases, giving effect to appellate orders, rectification of mistakes *etc.*, and giving instructions to Inspectors and members of the ministerial staff. But to assign more important functions, the Commissioner is required to obtain the prior sanction of the Board.

(iv) The Board is empowered to distribute and allocate the work on functional basis amongst two or more Commissioners including Additional Commissioners appointed for the same area or the same assessees. Likewise, the Commissioner is authorised to allocate and distribute work on functional basis amongst two or more Inspecting Assistant Commissioners appointed for the same area or the same assessee.

During the pendency of any proceeding under the Act, if an income-tax authority is succeeded to by another, the successor may continue the proceeding from the stage at which the proceeding was left by the predecessor. In such a case the assessee has right to demand that before the proceedings is so continued—(i) the previous proceeding or any part thereof must be reopened *e.g.* a witness should be examined afresh and (ii) the assessee should be reheard before any order of assessment is passed against him.

Transfer of Cases: The Board and the Commissioner are the only two authorities empowered to transfer any case at any stage of the proceedings from one I.T.O. to another. The Commissioner can transfer a case only from one I.T.O. to another both being subordinate to him ; but the Board can transfer any case from any I.T.O. in India to any other I.T.O. In cases of such a transfer it is not necessary to reissue the notices which had already been issued by the I.T.O. from whom the case was transferred. The I.T.O. to whom the case is transferred is entitled to proceed further and deal with the case from the stage at which it was left by his predecessor. An order of transfer, in order to be effective need not be specific ; it may be expressed in general terms without reference to a case for a particular assessment year actually pending before an I.T.O. A transfer may also be made to take retrospective effect. It may be noted that the Act provides for transfer of cases only between and amongst Income-tax Officers but not between the other authorities under the Act.

The Appellate Tribunal (Section 252) : The Appellate Tribunal which consists of equal number of Judicial members and accountant members is constituted by the Central Government to exercise the powers vested in it by the Income-tax Act. One of the members of the Tribunal, ordinarily a judicial member, is appointed as the President of the Tribunal. The Central Government may appoint one or more members of the Appellate Tribunal to the Vice-President or, as the case may be, Vice Presidents thereof. It may appoint one of the Vice-Presidents to be the Senior Vice-President or a Vice-President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President by a general or special order in writing. The powers and functions of the Appellate Tribunal can be exercised and discharged by benches constituted from amongst the members of the Tribunal by the President of the Tribunal. Each bench consists of one judicial member and one accountant member. If the members of a bench differ in opinion on any point, the point is decided according to the opinion of the majority, if there is a majority. If the members are equally divided, the point/s on which there is a difference is or are referred by the President of the Tribunal to one or more of the members of the Tribunal and the decision of the majority on any point shall prevail. The Appellate Tribunal has the power to regulate its own procedure. In pursuance thereof it has drawn up a set of rules, which are known as the

(iii) POWERS OF INCOME-TAX AUTHORITIES (Sections 131 to 136)

(a) Discovery, Production of Evidence etc. (Section 131): The Commissioner of Income-tax, Commissioner (Appeals) as well as the Appellate Assistant Commissioner, Inspecting Assistant Commissioner and the Income-tax Officer have the powers vested in a Civil Court under the Code of Civil Procedure, 1908 while dealing with the following matters :—

(a) discovery and inspection ;
(b) enforcing the attendance of any person examining him on oath ;
(c) compelling the production of books of account and documents ; and
(d) issuing commissions.

The powers aforementioned are normally those exercisable by a Court when it is trying a suit. While exercising these powers the authorities act in a quasi-judicial capacity and ought to conform to the principles of judicial procedure. Under this Section the authorities are vested with the powers of and are bound to follow the duties of a Court. The rights and duties include : (i) to enforce the attendance of a witness whose evidence is material, (ii) to call for the assessee's books of account which are in the possession of a public authority, (iii) to examine any person, (iv) to make the necessary enquiries and investigations, (v) to examine the accounts and (vi) to take evidence on oath or otherwise *etc.*

When an Income-tax authority issues a summons to any person to attend to give evidence or to produce books of account or other documents, at a certain place and time and he fails to attend or produce the books of account or documents at the place or time in accordance with the requirements of the notice, the Income-tax authority concerned may impose upon him a fine of a sum not exceeding Rs. 100, as it thinks fit. Further, the said Income-tax authority is vested with the power to impound or retain in its custody for such period as it may think fit, any books of account or other documents produced before it in any proceeding under this Act. The powers are *unrestricted* in the case of all the authorities except the I.T.O. whose powers are subjected to two restrictions ; (i) he must record his reasons for impounding books of account or other documents ; and (ii) if he desires to retain in his custody any such books or documents for a period exceeding fifteen days (excluding holidays), he must obtain the prior approval of the Commissioner for the purpose. Impounding of books by an I.T.O. without recording the reasons therefor would be illegal and subsequent retention of books thus illegally impounded would be equally illegal, even if the approval of the Commissioner is obtained later on.

Income-tax Officers, Appellate Assistant Commissioners, Inspecting Assistant Commissioners and Commissioners have been exercising their powers of discovery and inspection, enforcing the attendance of any person, compelling the production of books of account and other documents and issuing commissions. The law confers on the Assistant Directors of Inspection also all such powers [illegible] the Income-[illegible]

Officer exercises even though, no proceedings with respect to the person or class of persons concerned may be pending before him or before any other Income-tax authority in the matter of assessment, reassessment, penalty, etc.

(b) **Search and seizure** (Section 132) : Under this Section wide powers of search and seizure are conferred on the income-tax authorities. The important points relating to this provision have been briefly summarised below.

The provisions of the Criminal Procedure Code relating to searches and seizure would, as for as possible, apply to the searches and seizures under this Act. The exercise of these powers by the authorities are regulated by Rules 112, 112A, 112B, and 112C of the Income-tax Rules, 1962. Contravention of the orders issued under this Section would be punishable with imprisonment and fine under Section 275A. If the action taken by the authorities is *mala fide* or arbitrary or is not in compliance with the requirements and safeguards, the action would be illegal and the Court would interfere with the rights of the authorities. A sweeping or unwarranted search or seizure of documents or things irrespective of their relevance or usefulness for some important proceeding under the Act would not be a legally valid exercise of this power by the authorities.

1. Search and seizure can be authorised by the Director of Inspection or by the Commissioner of Income-tax, and also by such Deputy Director of Inspection and Inspecting Assistant Commissioners as may be specifically empowered by the Central Board of Direct Taxes for this purpose. While the Directors of Inspection and Commissioners of Income-tax will have the power to authorise Deputy Directors of Inspection and Income-tax Officers to carry out any search, the Deputy Directors of Inspection and Inspecting Assistant Commissioners, specifically empowered by the Board, would be able to authorise only Assistant Directors of Inspection and Income-tax Officers for the purpose.

2. Such authorisation could take place if the authority believes, on the basis of information in his possession :

(a) that the person to whom a summons was issued to produce books of account or other documents has wilfully omitted or failed to do so ; or

(b) that a person to whom a summons or a notice has been or might be issued, does not or would not produce any books of account or other documents called for or which will be useful or relevant to any proceeding under the Income-tax Act ; or

(c) that a person who is in possession of any articles or things, including money, bullion or jewellery *etc.* (which has not been disclosed by him) or that such property would not be disclosed by the person concerned for income-tax purposes in future he can authorise any officer, subordinate to him, not below the rank of an

Income-tax Officer to enter and search any building or place.

3. Such an authorisation can empower the authorised officer to enter any building or place or vehicle, vessel or aircraft where he has reasons to suspect that such books of account, documents, articles including money, jewellery, valuables *etc.*, are kept and in case they are found, he may seize them, place marks of identification on them or make a note or inventory thereof for the purpose. In the discharge of such a duty, he is authorised to break open the locks in case keys are not readily available. But the books of account and other documents seized should be retured within a period of 180 days from the date of seizure, unles authorised by the Commissioner of Income-tax otherwise. The books or other records cannot be retained for a period exceeding 30 days after the assessment proceedings for the relevant year are over. The persons from whose custody any books of account or other documents have been seized may make copies thereof or take extracts therefrom.

4. Under Rule 112(5) of the Income-tax Rules, the Authorised Officer is empowered to search any person in or about the building or place in respect to which a search has been authorised, if he has reason to suspect that any article for which the search is being made is concealed about his person. This Authorised Officer is also entitled to search any person who has got out of or is able to get into or is in the building, place, vessel, vehicle or aircraft in respect of which a search has been authorised, if he has reason to suspect that such person has secreted about his person any books of account or other documents, money, bullion, jewellery or other valuable articles for which the search is being made.

5. The Commissioner of Income-tax has the power to authorise a search of any building, place, vessel, vehicle, aircraft *etc.*, within his territorial jurisdiction and also in cases where he has no jurisdiction over the persons concerned, if he has reason to believe that any delay in obtaining authorisation from the Commissioner having jurisdiction over the person would be prejudicial to the interests of revenue.

6. Where a search for any books of account or other documents or assets has been authorised by any authority who is competent to do so, and the Commissioner has reason to suspect that such books of account or the documents of the assessee are kept in any building, place, vessel, vehicle or aircraft not specified in the search warrant he may authorise the authorised officer to search such other building, place, vessel, vehicle or aircraft.

Accordingly, if a search warrant is issued by the Commissioner of Income-tax, Bombay, authorising the search of a premises in Madras and the Authorised Officer finds that the books of account or other

documents and/or assets have been secreted in a building or place not specified in the search warrant, he could request any of the local Commissioners to authorise him to search that building or place.

7. Now there is a rebuttable presumption to the effect that the books of account or other documents and assets found in the possession of any person in the course of a search belong to such person and also that the contents of such books of account and other documents are true and that the signature and every other part of such books of account and other documents are in the hand-writing of the persons who can reasonably be assumed to have signed or written the books of account or other documents.

8. Under-Section 132(5), a summary assessment has to be made by the Income-tax Officer with the previous approval of the Commissioner of Income-tax or the Inspecting Assistant Commissioner within 90 days of the seizure.

9. Under Section 132(5), the Income-tax Officer is entitled to retain, out of the assets seized in the course of a search, such assets as would be sufficient to satisfy the tax payable on the estimated undisclosed income as also the existing liabilities, if any, under direct taxes laws, as well as the amount of interest payable and the amount of penalty imposable.

10. The Authorised Officer, if he is not the Assessing Officer, is required to hand over the books of accounts, *etc.*, seized by him to the Assessing Officer within a period of 15 days from the date of the seizure ; and thereafter, the powers and function of the Authorised Officer under Section 132(8) and (9) would be exercised by the Assessing Officer.

(c) **Power to requisition Books of Account etc.**, Section 132A provides that in case where any books of account or other documents and assets have been taken into custody by the Officer or authority under any other law (*e.g.*,) by the Collector of Customs, the Sales-tax Commissioner *etc.*, the Director of Inspection or Commissioner of Income-tax may, in such circumstances as are covered by Section 132 for search and seizure, authorise any Deputy Director of Inspection, Inspecting Assistant Commissioner, Assistant Director of Inspection or the Income-tax Officer to require such Officer or authority to deliver to him such books of account or other documents and assets. In case where such a requisition is made the Officer or the authority concerned would be required to deliver the books of account or other documents and assets to the requisiting Officer either forthwith or, when such Officer or the authority is of the opinion that it is no longer necessary to retain the same in his custody. Rule 112D of the Income-tax Rules is also relevant.

(d) **Application of retained Assets** (Section 132B) : The assets retained by the Director of Inspection or the Commissioner by virtue of the exercise of the

power of search and seizure under Section 132 must be utilised for the recovery of the entire amount of existing liability, in respect of tax payable on completion of regular assessments or reassessments for all the assessment years relevant to the previous year to which the estimated undisclosed income relates and in respect of which the person concerned is or is deemed to be in default.

If the assets seized consists partly of money and partly of other assets, the Income-tax Officer may apply the money in the discharge of the tax liability referred to above and hold over the assets either for being returned to the assessee or for being sold and applied towards the discharge of the liability. Until assets are so disposed of, they shall be deemed to be under a distraint in the process of recovery of taxes. This method of recovery is over and above the other methods available under the Act.

In order to prevent assets from being held unnecessarily or in excess of the time allowed, it is provided that the Government shall pay simple interest at 12% p.a. on the amount by which the aggregate of the money retained plus the sale proceeds, if any, of the assets sold towards the satisfaction of the tax liability exceeds the total amount of liability referred to in the order under Section 132 (5). The interest shall be calculated from the date of the order under Section 132 (5) to the date of the regular assessment. Further Rule 112C provides that any assets or proceeds thereof, which remain after the tax liabilities have been discharged, shall be forthwith made over or paid to the person from whose custody the assets were seized, in the presence of two respectable persons.

(e) **Power to call for Information and Registers of Companies** (Sections 133, 134): The Commissioner of Income-tax and the authorities subordinate to him as well as the Commissioner (Appeals and Appellate Assistant Commissioner) can call for a variety of information from the assessees and their business associates as well as those with whom they have had dealings in some capacity or the other. They are also authorised to take out copies of any register of members, debenture-holders or mortgages and charges etc., of any company or of any entry in such a register under Section 184.

(f) **Power of Survey**: (Section 133A): Income-tax authority may enter any place within the limits of the area assigned to him or any place occupied by any person in respeet of whom he exercises jurisdiction, at which a business or profession is carried on and require any proprietor, employee or any other person/s, who may at that time/place be attending in any manner to or helping him to carry on any such business or profession. This power may be exercised—

(i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place;

(ii) to afford him the necessary facility to check or verify the stock or other valuable articles or things which may be found therein ; and

(iii) to collect such information as he may require as to any matter which may be useful for or relevant to any proceeding under the Income-tax Act.

This power may be exercised in respect of any place with which the assessee is connected, whether or not such place is the principal place of business or profession. It will also include any other place, whether any business or profession is carried on therein or not, in which the person carrying on the business or profession states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession is kept. The Income-tax authority may enter any place of business or profession mentioned above only during the hours at which such place is/are open for the conduct of business or profession and in the case of any other place, only after sunrise and before sunset.

The Income-tax authority exercising this power of survey may—

(i) place marks of identification if he finds it necessary on the books of accounts or other documents inspected by him and make or cause to be made extracts or copies therefrom ;

(ii) make an inventory of any cash, stock or other valuable article or thing checked or verified by him ; and

(iii) record the statements of any person which may be useful for or relevant to any proceeding under the Income-tax Act.

The powers of survey are vested in the Income-tax Officers or Inspectors of Income-tax, authorised by them in this behalf, Inspecting Assistant Commissioners and Assistant Directors of Inspection. These authorities are entitled to inspect the books of account and other documents available at the place of business *etc.* and to check or verify the cash, stocks or other valuables found in the premises where the business or profession is carried on and also to require the proprietor, employee, *etc.*, to furnish any information which may be useful for purposes of any proceedings under the Income-tax Law.

The Income-tax authorities would also have the power to collect information and record the statements of any of the persons concerned at any time after any function, ceremony or event even before the stage of commencement of assessment proceedings for the following year for which the information may be relevant, if they are of the opinion that having due regard to the nature, scale and extent of the expenditure incurred, it is necessary to do so. This provision is intended to help in collecting evidence about ostentatious expenditure immediately after the event to be used at the time of the assessment.

If any person who is required to provide facility to the Income-tax Officer to inspect the books of account or the other documents or to check or verify any cash, stock or other valuable articles or to furnish any information or to have his statement recorded either refuses or evades to do so, the Income-tax authority would be entitled to use all the powers vested in it under Section 131(1) and (2) for enforcing proper compliance with the requirements.

(g) **Other Powers** (Section 135 and 136) : The Director of Inspection, the Commissioner and the Inspecting Assistant Commissioner are competent to make any enquiry under Section 135 and for all purposes they shall have the powers vested in an Income-tax Officer in relation to the making of enquiries.

If the Investigating Officer is denied entry into the premises, the Income-tax Officer shall have all the powers vested in him under Section 131 (1) and (2). All the proceedings before Income-tax authorities are judicial proceedings for purposes of Section 96 of the Indian Penal Code and fall with the meaning of Section 193 and 228 of the Code (Section 136).

(iv) DISCLOSURE OF INFORMATION REGARDING ASSESSEES (Section 138).

If a person makes an application in accordance with Rule 113 of the Income-tax Rules, 1962 to the Commissioner of Income-tax in the prescribed form for obtaining any information relating to any assessee in respect of any assessment year, the Commissioner may, if he is satisfied that it is in the public interest, furnish the information. His decision in this regard cannot be called into question. Nevertheless, the Government may, having regard to practice and usage customary or otherwise, and any other relevant factors, direct that no information or documents shall be furnished or produced by a public servant in respect of such matters relating to a particular class or classes of assessees except to certain authorities which may be specified. It would be observed that, under Section 138, the Commissioner can make a disclosure on the basis of an application made to him; he cannot volunteer to give the information.

Further, the Board has been empowered to furnish or cause to be furnished any information relating to any assessee in respect of assessment under the Income-tax Act to any office or authority or body performing any function under any law relating to the imposition of any tax, duty or cess or dealings in foreign exchange in all cases where the Board considers such information necessary for the purpose of enabling the officer, authority or body to perform his or its functions under that law. This power of disclosure of information can as well be exercised by any other Income-tax authority specified by the Board by a general or special order in this behalf. It will also be open to the Central Government to notify any officer, authority or body performing functions under any other law and on such notification, the Board or any other Income-tax authority may furnish or cause to be furnished

similiar information relating to any assessee to the officer, authority or body concerned.

2. *PROCEDURE FOR ASSESSMENT* (Section 139 to 146)

Return of Income : *Section 139 specifically provides that every person must file a return of his total income or the total income of any other person in respect of which he is assessable under the* Act, by a specified date ; but the Section provides for extension of the date for filing the return upto a certain period upon payment of interest. Further, the Section requires the submission of a return of loss in the same way as a return of income in all cases including a loss under the head 'capital gains'. Assessees engaged in any business or profession must furnish such additional particulars as may be required. Different forms of returns have been prescribed for different classes of assessees with respect to the various sources of income by Rule 12 of the Income-tax Rules, 1962. Broadly, one form has been prescribed for companies and three other forms have been prescribed for other assessees. Students may refer to Forms No. 1, 2, 3 and 3A of the Appendix to the Income-tax Rules, 1962 for a detailed study of the information required to be furnished by different tax payers as part of the Income-tax Return.

The prescribed form of return requires an assessee who is engaged in a business or profession to furnish particulars as to the location and style of the principal place where the business or profession is carried on, the balances thereof, the names and addresses of its partners, if any, and the extent of the share of each partner, *etc.*

The different types of returns to be furnished by assessees are stated below :—

(*i*) *Voluntary Return* [Sub-Section (1)] : A statutory obligation has been cast on every person to furnish voluntarily a return (a) of his total income [including the income of other persons in respect of which he is taxable under Sections 60 to 65 and the income-tax on which was sought to be avoided falling under Sections 92 to 94] or (b) of the total income of any other person/s, in respect of which he is assessable, for every assessment year, if the total income exceeds the maximum amount not chargeable to income-tax in his case. For example, a representative assessee under Section 160 would have to file a return in respect of the total income of a non-resident, a minor or a beneficiary. In other words, it is the sole responsibility of the assessee to furnish a return of his total income, which is chargeable to income-tax for any assessment year, in the prescribed form within the prescribed time and verified in the prescribed manner.

Option to Salaried Taxpayers for not filing Returns of Income : Section 139 (1A) provides that it is not necessary for a person to furnish a voluntary return of his income (or the income of any other person in respect of whose total income he is assessable), if his total income (or the total income of such other person) consists

only of income chargeable under the head "Salaries" or of income chargeable under that head and also income of the nature of dividends or interest or the income from units of the Unit Trust of India *etc.*, referred to in clause (i) to (ix) of sub-section (1) of Section 80 L. The requirement of furnishing voluntary return in such cases will be waived only if certain conditions specified in this behalf are fulfilled. These conditions are :-

(a) If the person concerned was employed by a company at any time during the relevant year, he should not have been at any time during that year a director of the company or a person having a substantial interest in the company.

(b) The salary of the person concerned (exclusive of the value of benefits or amenities not provided for by way of monetary payment) *should not exceed Rs. 18,000.*

(c) The income, if any, of the person concerned of the nature referred to in clause (i) to (ix) of sub-section (1) of Section 80L should not exceed Rs. 3,000 in the aggregate.

(d) The tax deductible at source under Section 192 of the Income-tax Act from the income chargeable under the head "Salaries" should have been deducted.

(e) The requirement of filing a voluntary return of income has not been waived in the case of directors of companies, persons holding substantial interest in companies and persons receiving salary exceeding Rs. 18,000 because the value of the benefits or amenities provided to such taxpayers in kind has to be determined by the Income-tax Officer and assessed to income-tax.

(ii) *Return after Notice* [Sub-Section (2)] : The I.T.O. may issue and then serve a notice on an assessee or representative assessee whose total income, in the opinion of the I.T.O. would be sufficient enough to make him liable to tax under the Act, requiring him to furnish a return within 30 days of the date of the notice. The I.T.O. is entitled to issue this notice at any time during the assessment year. A return filed by the assessee after receiving a notice from the I.T.O. is not called a voluntary return even if he had prepared, but not submitted the return before the receipt of the notice.

On receipt of an application from the assessee, if the I.T.O. has issued a notice, he may, in his discretion, extend the date for furnishing the return. Notwithstanding the fact that an extension has been granted, interest is chargeable from the assessee in every case where the return is filed beyond the time limits prescribed under provisions of Section 139 (1) or otherwise.

Legally, it is not the duty of the I.T.O. to issue a notice in every case and hence the non-receipt of a general or specific notice from the I.T.O. cannot be an excuse for not filing a return. The requirement as to submission of a return applies

to all assessees irrespective of the fact whether they had previously been assessed or not and whether or not he has any taxable income.

(iii) *Belated Return* [Sub-Section (4)] : If an assessee does not submit his return of income before the time allowed to him either voluntarily or on receipt of a notice from the I.T.O. he may furnish a return at any time before the assessment is made ; such return is called a belated return. Such a return can, therefore, be filed even after the expiry of the assessment year, but before the assessment is made. Even if the assessee is late in filing his return the return must be considered and dealt with for assessment purposes. However, in case of failure without reasonable cause to furnish the return, the return may be furnished in the same or subsequent year and the return must be accepted and taken as the basis of assessment. If even a belated return is not filed the I.T.O. can proceed to make a best judgment assessment after serving a notice upon the assessee. If a belated return is filed after such an assessment is made it would be invalid even though it may be filed before the assessment order or the notice of demand is served on the assessee. A belated return should be furnished before the expiry of the prescribed period from the end of the assessment year to which the return relates, the prescribed period being two years for any assessment year commencing on or after 1-4-1969. Belated returns filed after the expiry of these time limits, would be invalid and must be ignored by the I.T.O. This time limit does not apply to a return filed in response to a notice from the I.T.O. under Section 148 issued for the purpose of charging to tax the income that has escaped assessment.

(iv) *Revised Return* [Sub-Section (5)] : If a person who has already filed a return finds any mistake, omission or wrong statement therein, he can file a revised return at any time before the assessment is made. But the right to file a revised return cannot be claimed by an assessee who wilfully or intentionally filed a false return. Even if a revised return is filed by the assessee who filed a false return earlier, he cannot escape the penalty that may be levied on him for filing a false return. The revised return also must be made in the prescribed form and verified in the prescribed manner having specific reference in the return originally filed. A mere application or letter giving clarification or providing particulars *in lieu* of or in addition to the original return cannot be taken as a revised return for this purpose.

The Delhi High Court has in *Malhotra v. CIT 129 ITR 379* held that an assessee who has filed a belated return under sub section (4) is not entitled to file a revised return under sub section (5). However the Calcutta High Court has held that sub section (4) merely extends the time for filing a return under sub-section (1) or (2) and therefore an assessee who has filed a return pursuant to sub-section (4) is not debarred from filing a revised return. *Zulekha Begum v. CIT (129 ITR 560)*. In short, there is a judicial controversy on this issue.

(v) *Return of Loss* [Sub-Section (3)]. The Provisions of this Section require the assessee to file a return of loss in the same manner as in the case of return of income, Under Section 80 it is specially stated that an assessee cannot carry forward or set off his loss against income in the same or subsequent year *unless* he has filed a return of loss within the time allowed. A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the I.T.O. requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return. In particular a return of loss must be filed by an assessee who has incurred a loss under the heads "income from business or profession" and "capital gains."

It is obligatory for every assessee who is the owner of race horses to file a return of the loss incurred by him on account of the maintenance of his race horses. The time limit for filing the return and other procedural formalities to be complied with are the same as in the case of return of income whether voluntarily or on receipt of a notice. The Income-tax Officer is empowered to extend the time for the filing of the return of loss on receipt of an application made by assessee in the prescribed manner.

Time Limit : The prescribed time for assessee whose total income includes any income from business or profession is any date before the expiry of *four months* from the end of the previous year, if there is only one previous year or, where there are more previous years than one from the end of that previous year which expired last before the commencement of the assessment year or before the 30th day of June of the assessment year, whichever is later. In the case of other assessees whose total income does not include any such business or professional income, the prescribed time is any date before the 30th day of June of the assessment year regardless of the accounting year and the method of accounting followed by him.

Extension of the Time-limit : If an assessee, for any reason, considers that he would not be able to furnish a return in respect of his total income, whether voluntarily or on receipt of a notice from the I.T.O. within the prescribed time-limit for any assessment year, he must submit an application in the prescribed manner (See Rule 18, From 6) to the Income-tax Officer for the extension of the date for furnishing the return. The Income-tax Officer can exercise discretion in this regard. Application for extension of time may be made even after the time for filing the return has expired.

When an extension of time for the furnishing of the return of income is allowed beyond the prescribed dates in the case of a registered firm or an unregistered firm which has been assessed as registered, interest @12% p.a. shall be charged on the amount of tax which would have been payable if the firm had been assessed as an unregistered firm. In the case of any other assessee, the

interest shall be charged on the amount of tax payable on the total income of the assessee finally assessed, reduced by the advance tax, if any, paid or by any tax deducted at source, as the case may be.

Other Particulars to be furnished : According to the sub-section (6) of Section 139, the prescribed form of return of income should also require the assessee to furnish the particulars of his income which are exempt from tax, details of the assets of the prescribed value and belonging to him, and also details of the expenses exceeding the prescribed limits incurred by him under the specified heads as well as details of such other outgoings or payments as may be prescribed by the Central Board of Direct Taxes.

Sub-section (6A) of Section 139, provides that in the case of an assessee engaged in business or profession, the prescribed form of return of income should also require the assessee to furnish particulars of the location and style of the principal place of the business or profession and also the branches thereof, the names and addresses of the partners if any, and if the assessee is a member of association of persons or body of individuals, the names of the other members of the association or the body of individuals and also the extent of the share of the assessee and the shares of all such partners or members as the case may be, in the profits and losses of the business or profession or any branches thereof. These new provisions have thus authorised the Central Board of Direct Taxes to require an assessee to furnish the various details of his other financial activities or involvements which may not otherwise be furnished by the taxpayers as part of their income-tax return.

Interest payable [Sub-Section (8)] : In all cases where a return of income is either furnished late or had not been furnished the assessee shall be liable to pay simple interest @12% p.a. in addition to the tax fine and penalty payable by him. This liability to pay interest arises in every case whether the I.T.O. had given extension of the time for furnishing the return or not. The interest must be calculated :

(i) in the case of a belated return, from the expiry of the prescribed date (or specified date) to the date of furnishing the return ;

(ii) in the case of failure to file the return, from the expiry of the due date to the date of completion of the assessment under Section 144 on the amount of tax payable on the total income as determined on regular assessment, as reduced by the advance tax, if any, paid and tax deducted at source.

For instance, an assessee whose accounting years for his business ends on 31-3-83 must submit his return of income under Section 139 (1) on or before 31-7-1983. If he furnishes his return on 31-12-1983 the interest payable for this default will be computed for the period from 1-8-1983 to 31-12-1983 irrespective of the fact whether (i) the delay is deliberate and intentional or unavoidable

and (ii) the I.T.O. had granted extension of time for filing the return or not.

According to the Explanation 1 for the purpose of charging interest, the *specified date* within which the return is to be filed means :—

(i) In the case of every assessee whose total income, or the total income of other person in respect of which he is assessable includes any income from business or profession the date of the expiry of four months from the end of the accounting year :

If the assessee has more accounting years than one, the period of four months should be reckoned from the end of that accounting year which expired last before the beginning of the assessment year or the 30th June of the assessment year, whichever is later.

(ii) In the case of assessee who does not have any income from business or profession—the 30th June of the assessment year.

Moreover, for the purpose of charging interest in cases where the assessee is a registered firm or an unregistered firm which is assessed as a registered firm under Section 183 (b) the tax payable on the total income shall be the amount of tax which would have been payable if the firm had been assessed as an unregistered firm. In cases where, as a result of an order of rectification of mistake on appeal, reference or revision, the amount of tax on which interest was payable has been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded to the assessee [Explanation 2].

Waiver or reduction of interest [Proviso to Section 139(8)] : The Income-tax Officer, however, is empowered, in snch cases and under such circumstances as may be prescribed, to reduce or waive the interest payable by the assessee for delay or default in furnishing the return. Under Rule 117A the I.T.O. may waive or reduce the amount of interest, payable in the following circumstances :

(i) where the return of income is furnished by a person who has been treated as the agent of a non resident under Section 163 and is assessed in respect of the latter's income.

(ii) where the return is furnished by an assessee whose only source of income during the relevant previous year is a share in the income of unregistered firm which has been assessed on its total income in respect of that previous years as registered under Section 183 (b) ;

(iii) where the return of income of a deceased individual is furnished by his legal representative and the legal representative satisfies the I. T. O. that he had sufficient cause for not filing such return within the time allowed;

(iv) where the return of income has been furnished in pursuance of a notice under Section 148 issued to assess the escaped or concealed income; and

(v) in any other case in which the assessee produces evidence to the satisfac-

tion of the I.T.O. that he was prevented by sufficient casue from furnishing the return within the prescribed time.

However the I.T.O. must obtain the prior approval of the Inspecting Assistant Commissioner in cases where the amount of interest sought to be reduced or waived exceeds Rs. 1,000 in the circnmstances specified in (iv) and (v) above.

Rule 119A provides a procedure to be followed in calculating interest. According to the rule the period for which such interest is to be calculated shall be rounded off to a whole month and for this purpose any fraction of a month has to be ignored. In the same way the amount of tax, penalty or other sum in respect of which such interest is to be calculated shall be rounded off to the nearest multiple of one hundred rupees.

Defective Return [*Section 139 (9)*] : Under this sub-section I.T.O. has power to call upon the assessee to rectify a defective return. For the purposes of this sub section, a return of income shall be regarded as defective unless all the following conditions are fulfilled, namely :—

(a) The annexures, statements and columan in the return of income relating to computation of income chargeable under each head of income, computation of gross total income and total income have been duly filled in

(b) The return of income is accompanied by the following, namely :—

(i) A statement showing the computation of the tax payable on the basis of the return ;

(ii) The proof of the tax, if any, claimed to have been deducted at source and the advance tax and tax on self-assessment, if any, claimed to have been paid ;

(iii) The proof of the amount of compulsory deposit, if any, claimed to have been made under the Compulsory Deposit Scheme (Income-tax Payers Act, 1974 :

(iv) where regular books of account are maintained by an assessee :

(1) copies of manufacturing account, trading account, profit and loss account : or income and expenditure account, or any other similar account and balance sheet ;

(2) in the case of a proprietary business or profession, the personal account of the proprictor ; in the case of firm, association of persons or body of individuals, personal accounts of the partners or members ; and in the case of partner or member of a firm. association of persons or body of individuals, also his personal account in the firm, association of parsons or body of individuals ;

(v) where the accounts of the assessee have been audited, copies of the

audited profit and loss account and balance sheet and a copy of the auditor's report,

(vi) where regular books of account are not maintained by the assessee, a statement indicating the amounts of turnover or gross receipts, gross profit expenses and net profit of the business or profession and the basis on which such amounts have been computed, as also of the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

Where the Income-tax Officer considers that the return of income furnished by the assessee is defective he is given the discretion to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of fifteen days from the date of intimation or within such further extended time as the Income-tax Officer may allow. If the defect is not rectified within the period of fifteen days or such further extended period then, the Income.tax Officer shall treat the return as an invalid return and other provisions of the Income-tax Act shall apply as if the assessee had failed to furnish the return. Where, however, the assessee rectifies the defect after the expiry of the period of fifteen days or the further extended period, *but before assessment is made*, the Income-tax Officer has been empowered to condone the delay and treat the return as a valid return.

The defective return is not automatically an invalid return. If the assessee rectifies the defect it becomes valid. It is to be noted here that Section 292B provides inter alia that no return of income shall be invalid merely by reason of any mistake, defect or omission therein. But Section 139(9) overrides Section 292B for Section 139(9) specifically states that its provisions will prevail "notwithstanding anything contained in any other provision of the Act."

Retnrn of Income of Charitable Trusts and Institutions [*Section 139 (4A)*] : Every person in receipt of income (i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose or (ii) by way of voluntary contributions on behalf of such trust or institution must furnish a return of income in all cases where the total income (computed before allowing any exemption under Sections 11 and 12) exceeds the maximum amount not chargeable to income-tax. The return must be furnished in the prescribed form and verified in the prescribed manner and should contain all the particulars prescribed for this purpose. This return must be filed by the representative assessee voluntarily within the time limits ; any failure on the part of the assessee would attract liability to pay interest and penalty as in other cases.

Return of Income of Political Parties [Section 139 (4B)] : The grant of exemption from income-tax to any political party under Section 13A is subject to the condition that the political party submits a return of its total income on or before 30th June of the relevant assessment year to the Income-tax Officer having

jurisdiction to assess the party. The Chief Executive Officer of the political party is statutorily required to furnish a return of the total income of the party for the assessment year if the amount of total income exceeds the basic exemption admissible to it and for this purpose the amount of total income must be determined before taking into account the exemption granted under Section 13A of the Income-tax Act. The return must be filed in the prescribed form and verified in the prescribed manner setting forth such other particulars as may be prescribed by the Central Board of Direct Taxes. Any failure to furnish the return of the income might make the party attract liability to penalty and/or interest. The requirement in the matter of filing of return may be regarded as being somewhat similar to the requirement for filing return which is statutorily made obligatory for charitable trusts and institutions.

Exceptions : It may, however, be noted that any notice issued by the I.T.O. under Section 139(2) requiring the assessee to submit a return of his income for a lesser period than the period of thirty days is invalid. Such an invalidity is incurable in any manner except by the issue of a fresh notice within the assessment year. In the undermentioned three cases, however, the Income-tax Officer is empowered to curtail the aforesaid period of 30 days, *viz.*,

(i) when the assessee is leaving India with no present intention of coming back (Section 174) ;

(ii) when a person is proposing to alienate his assets with a view to avoiding payment of tax (Section 175) ; or

(iii) where any business or profession is discontinued (Section 176)

Even in these three circumstances, the period of notice may be reduced to seven days but not less. Although these cases do not directly fall within the purview of Section 139(2), nevertheless this notice shall be treated, for all purposes, as a notice under Section 139(2).

Permanent Account Numbers : According to Section 139A the following requirements must be complied with by the taxpayers.

1. Every person having a taxable income who has not been allotted a permanent account number must, within the prescribed time, apply to the Income-tax Officer for the allotment of a permanent account number.

2. Every person carrying on business whose sales turnover or gross receipts are likely to exceed Rs. 50,000 in any year, and who has not been allotted a permanent account number, must also apply to the Income-tax Officer within the prescribed time for the allotment of a permanent account number.

3. The Income-tax Officer may also allot to any other person by whom tax is payable, a permanent account number.

4. Permanent account numbers already allotted by the Incom-tax Department shall, with effect from such date as the Central Board of Direct Taxes may notify in the Official Gazette be deemed to have been allotted under the new provisions.

5. In cases where a permanent account number has already been allotted, the person concerned must quote the number in all his returns to or correspondence with any Income-tax authority and in all challans for the payment of any sum due under the Income-tax Act and in all documents relating to such transactions as may be drescribed by the Central Board of Direct Taxes having due regard to the interests of the revenue.

6. Every person to whom a permanent account number has been allotted must inform the Income-tax Officer of any change in his address or his name and the nature of his business.

Signature on the return (Section 140) : The return of income should be signed—

(i) (a) *in the case of an individual*—by the individual himself personally and not by his agent even if the agent holds a power of attorney. (b) *where the individual is absent from India*—by the individual concerned or by some person duly authorised by him in this behalf, and (c) *where the individual is mentally incapacitated from attending to his affairs*—by his guardian or any other person competent to act on his behalf ; [Items (b) and (c) constitute the only two exceptions to the rule that the individual must sign his return personally].

(ii) *in the case of a Hindu undivided family*—by the Karta and, where the Karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of the family ;

(iii) *in the case of a company*—by its managing director or, where, for unavoidable reasons, the managing director is not able to sign and verify the return or, where there is no managing director by any director of the company.

(iv) *in the case of a firm*—by any partner thereof not being a minor ;

(v) *in the case of any other association*—by any member of the association or the principal officer thereof ;

(vi) *in the case of a local authority*—by its principal officer ; and

(vii) *in the case of any other person*—by that person or by the person competent to act on his behalf.

The assessment proceedings against an assessee for any year commence from

the moment he furnishes the return of his total income for that year or requests, by making an application in that behalf, for extension of the date for furnishing the return; where he does not himself voluntarily furnish a return of his total income the proceedings commence from the moment he is served with a notice requiring him to file a return of his total income.

Enquiry befor assessment : Under Section 142 the Income-tax Officer can direct an assessee to produce or cause to be produced books of accounts or to furnish information in the prescribed manner. Such a direction can be made to (1) a person who has filed a return under Section 139 or (2) any person to whom a notice has been issued whether he had filed a return or not. But in both cases the notice requiring production of accounts must be issued before the assessment is finally made. The ITO's discretion to issue a notice under this section is unfettered and cannot be questioned by the assessee in any appeal. The assessee has to comply with the notice which is in the nature of enquiry before assessment even if he thinks that the accounts or documents required by the ITO are irrelevant. While issuing the notice, the ITO must give the assessee a reasonable time to produce the accounts and documents.

In making the requisition under Section 142 (1) the ITO cannot require production of any accounts relating to a period which expired more than three years prior to the commencement of the previous year. But no such time limit is prescribed for documents. If the ITO by a single notice requires the assessee to produce accounts of three years prior to the accounting years as well as of any earlier year, the whole notice is not invalid but is bad only to the extent to which it relates to the accounts of the earlier years. Consequently, if there is a failure on the part of the assessee to produce the accounts of the three years prior to the accounting year in response to such a notice, a best judgment assessment cannot be made by the ITO.

The ITO can also require the assessee to furnish in writing and verified in the prescribed manner information including a statement of all assets and liabilities of the assessee, whether included in the accounts or not. The prior approval of the Inspecting Assistant Commissioner is necessary when the ITO requires a statement of assets and liabilities not included in the accounts.

Where the business is carried on in several places the assessment of the total profits must be made by the ITO having jurisdiction at the principal place of business. He can call for the accounts pertaining to any branch office even if independent enquiries have already been made and the accounts have been examined by the ITO exercising jurisdiction at the branch. Similarly, the ITO has power to call for the account books of a foreign business carried on abroad provided that such books are in the possession or control of the assessee. But an Indian company cannot be called upon to produce the books of a foreign

company (which are not in the possession or control of the Indian company) simply because the two companies are on friendly terms.

Tax Audit : Sub-sections (2A), (2B), (2C), and (2D). of section 142 contain the statutory provisions relating to the conduct of tax audit. Students may note that the Tax Audit envisaged under this provision is different from the Compulsory Tax Audit under the new provisions of Section 44 AB. A summary of these provisions is given below :

1. The Income-tax Officer has got the power to direct the assessee to get his accounts audited by an accountant if, at any stage of the proceedings before him, he is of the opinion that it is necessary for him to get the accounts audited. The opinion of the Income-tax Officer on the basis of which a direction for getting tax audit done should be arrived at after having due regard to the nature and complexity of the accounts of the assessee and the interests of the revenue. Before giving any direction to the assessse for getting tax audit done the Income-tax Officer must obtain the approval of the Commissioner of Income-tax.

   The expression '*accountant*' for this purpose means a 'chartered accountant' within the meaning of the Chartered Accountants Act, 1949 and includes, in relation to any State, any person who, by virtue of the provisions of Section 226(2) of the Companies Act, 1956 is entitled to be appointed to act as an auditor of companies registered in that State.

2. The auditor by whom tax audit should be carried out would be nominated by the Commissioner of Income-tax specifically for the purpose and the auditor is required to furnish the report of his audit in the prescribed form duly signed and verified by him and setting forth such other particulars as may be prescribed and also giving details in regard to such additional particulars as the Income-tax Officer may require in respect of each individual case. The report of the tax auditor should be furnished in Form No. 6B prescribed under Rule 14A of the Income-tax Rules, 1962. The auditor appointed for carrying out tax audit becomes liable to carry out the requirements of audit as directed by the Income-tax Officer and it is the Commissioner and not the assessee who would be his client for this purpose.

3. The Income-tax Officer is empowered to direct tax audit to be carried out in the case of any particular assessee even if the accounts of the assessee have already been audited under any other law for the time being in force or otherwise.

4. The report of the auditor after conducting tax audit must be furnished to Income-tax Officer by the assessee within the period specified by the

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Students may note that the Institute has published a Guide to Tax Audit for the guidance of members.

I.T.O. in his order. The Income-tax Officer is, however, entitled, on receipt of an application made in this behalf by the assessee for any good and sufficient reasons to extend the time-limit by such further period or periods as he deems fit. Further, the aggregate of the period originally fixed and the period or periods so extended should not exceed 182 days in any case. This time of 182 days must be reckoned from the date on which the Income-tax Officer's direction to get the accounts audited is received by the assessee.

5. The expenses of carrying out tax audit including any other incidental expenses which are incurred for the purpose and also the renumeration of the auditor must be determined by the Commissioner in every case. The amount so determined by the Commissioner is final and cannot be challenged either by the assessee or by the auditor in any court of law. The amount so determined must be paid by the assessee and in the event of the assessee's default in making the payment, the amount payable shall be recoverable from assessee as if it is an item of arrears of tax. Consequently, the provisions relating to collection and recovery of tax under Chapter XVII-D of the Act would be applicable.

6. The assessee should, however, be given an opportunity of being heard before the Income-tax Officer who makes use of the information obtained by him on the basis of the report of the audit carried out for tax purposes before making the assessment on the assessee. If, however, the assessment is in nature of a best judgment assessment under Section 144, it is not obligatory for the Income-tax Officer to give the assessee an opportunity to be heard, before passing the assessment order on the basis of the report of the auditor.

7. In any case, where the assessee is directed to get audit done and the assessee fails to do so, the Income-tax Officer is entitled to make a best judgment assessment under Section 144 in addition to imposing penalty or taking such steps as may be necessary under the law.

(e) **Best Judgment Assessment** (Section 144) : Where an assessee who has been served with a notice under Section 139(2) of the Act :

(i) has not submitted a return or revised return whether voluntarily or after receipt of a notice within the time allowed ; or

(ii) having filed a return, fails to comply with any or all the terms of the notices issued under Section 143(2) or :

(iii) where he fails to comply with any or all the terms of the notice issued under Section 142(1) or 142(2A) :

the Income-tax Officer, after taking into account all relevent materials gathered by him, shall make an assessment of the total income or loss of the assessee in respect

of the previous year to the best of his judgment and shall determine the sum payable by the assessee or refundable to him on the basis of such assessment. Such an assessment is called a best judgment assessment or an *exparte* assessment. In all cases stated above it is *mandatory* for the I.T.O. to make best judgment assessment and he has no discretion to make or not to make such an assessment. These three cases are alternative and not cumulative for the purpose of making an *exparte* assessment.

In a case whese a commissioner issued instructions under section 142(2A) and nominated a chartered accountant for auditing the assessee's accounts and through the concerned assessee was willing to produce the records, the concerned chartered accountant referred to audit the accounts, the question arose as to whether there was a failure on the assessee's part to comply with the directions under section 142(2A) and consequently best judgment assessment could be made under section 144(b).

The Supreme Court held that if for a frivolous reason the Chartered Accountant declined to undertake the audit of the assessee's accounts, obviously the assessee could not be held responsible. In such a case where there was no default or failure to comply with the directions issued under section 142(2A) on the assessee's part so as to attract the provisions of section 144(b). The best judgment assessment made by the I.T.O. was set aside with the directions to appoint another chartered accountant within one month for getting the accounts audited (Swadesh Polytax Ltd. v I.T.O. (1983) 15 Taxman 19(SC).

Different types of Assessments.

(a) **Self-Assessments.** (Section 140A) : This Section imposes a duty on every assessee to pay the tax on the basis of the return filed by him. The amount of the tax payable by the assessee on the basis of his own return of income which may be furnished either under Section 139 or under Section 148, after taking into account the amount of advance tax or the tax already deducted at source, must be paid by him before furnishing the return of income and the assessee should also furnish along with the return of income, the proof for payment of such tax.

In every case where the assessee fails to pay the tax or any part thereof before filing the return of his income on the basis of his own assessment the Income-tax Officer has the power to direct that penalty would be levied on the assessee for his default. He has, however, the discretion not to levy penalty. The amount of penalty would be a sum equal to 2% per month of the tax or part thereof, as the case may be, which ought to have been paid by the assessee before filing his return of income. However, the Income-tax Officer must give the assessee a reasonable opportunity of being heard before imposing penalty on him. There is no maximum limit on the amount of penalty that could be levied on account of this default. The penalty that could be levied would in some

cases be even larger than the amount of tax payable if the default or delay on the part of the assessee is for a long period.

(b) **Provisional Assessment for Refund:** Section 114A empowers the I.T.O. to make a provisional assessment of the sum refundable to a person on the basis of the return of income submitted by him and the accounts and documents accompanying it and to make a refund where the assessee claims that the advance tax paid by him or the tax deducted at source from any part of his income exceeds the tax payable on the basis of such return, aacounts and documents, if he is of the opinion that the regular assessment is likely to be delayed. On making a regular assessment, if it is found that the amount of refund allowed to the assessee on the provisional assessment is in excess of the amount due to him, such excess will be deemed to be tax payable by the assessee and be recoverable from him. It is obligatory for the I.T.O. to make the provisional assessment for refund in the circumstances mentioned above.

It is obligatory for the I.T.O. to make a provisional assessment for refund in all cases where a regular assessment is not made within six months from the date of receipt of the return from the assessee. He will make the provisional assessment after making the necessary adjustments to the income or loss declared in the return with reference to the return, accounts and documents as also with reference to the records of the past assessments, if any.

While making any adjustment for passing an order for provisional assessment refund the I.T.O. shall :

(i) rectify any arithmetical errors in the return, accounts and documents furnished by the assessee ;

(ii) allow any deduction, allowance or relief which, on the basis of the information available in such return, accounts and documents, is *prima facie*, admissible but is not claimed in the return ;

(iii) disallow any deduction, allowance or relief claimed in the return which, on the basis of the information available in such return, accounts and documents, is *prima facie*, inadmissible ; and

(iv) give effect, with reference to past assessment to the allowance of unabsorbed depreciation, development rebate, development allowance, investment allowance, capital expenditure on scientific research, patents or copy rights, certain preliminary expenses, expenses on the prospecting for or the extraction of any mineral or group of associated minerals, capital expenditure incurred by a company for family planning amongst its employees, unabsorbed business losses or losses under the head 'capital gains' brought forward from earlier years and the unabsorbed part of the tax holiday benefit as computed, in each case, in the regular assessment, if any, for the earlier assessment year or years.

The assessee has no right to appeal against a provisional assessment for refund and nothing done or suffered by reason or in consequence of any provisional assessment for refund shall prejudice the determination, on the merits of any issue which may arise in the course of the regular assessment.

(c) **Summary Assessment** [Section 143 (1)] : Under sub-section (1) of Section 143, the Income-tax Officer on receipt of the return of income may make a regular assessment without requiring the presence of the assessee or the production by him of any evidence in support of the return. In making such a summary assessment, the Income-tax Officer has the authority to make certain adjustments to the income or loss declared in the return. The adjustments are by way of—

(i) rectiying any arithmetical errors in the return, accounts and documents, if any accompanying it.

(ii) giving due effect to the deductions and allowances brought forward from earlier years, namely, unabsorbed depreciation [Section 32 (2)], unabsorbed investment allowance [Section 32A (3) (ii)], unabsorbed development rebate [Section 33 (2) (ii)]. unabsorbed development allowance [Section 33A (2) (ii)], unabsorbed amount of capital expenditure incurred on scientific research (Section 35 (2) (i)], capital expenditure on acquisition of patent rights and copy rights [Section 35A (1)], unabsorbed amount of certain preliminary expenses which are amortisable against profits [Section 35D (1)] expenditure on prospecting for or development of specifying minerals amortisable against profits [Section 35E (1)], capital expenditure on family planning incurred by an Indian company [Section 36 (1) (ix)], unabsorbed loss brought forward from earlier years which are admissible as set off [Section 72 (1), 73 (2), 74 (1) and 74A (3)] and deficiency in tax holiday profits which is liable for set off [Section 80J (3)].

Adjustments to be made in the summary assessment in regard to items listed in II above are to be based on the computation made in the regular assessmeet year, if any, for the earlier assessment year or years.

It is not within the rights of the Income-tax Officer to complete the assessment under this Section [Section 143(1)] by applying a higher rate of gross profit than that shown in the return, even though in the earlier assessment year profit was estimated in this manner and was confirmed in appeals.

(d) **Regular assessment :** Assessment under Section 143(1) is final in every respect except where proceedings are initiated under Section 148(2) by making fresh assessment. Where the assessee objects to the summary assessment under Section 143(1) he is required to make an application to the concerned

Income-tax Officer in form No. 6A within one month from the service of the notice issued in connection with the assessment under this Section.

On receipt of such application the Income-tax Officer shall issue a notice under Section 143(2) calling upon the assessee to produce any evidence in support of the return. The assessment will, however, be completed under Section 143(3).

1. In cases where the assessee objects, to the summary assessment under Section 143(1), interest for the disputed amount cannot be charged, and the assessee shall not be deemed to be in default in respect of the whole or any part of the amount of the tax demanded in pursuance of the summary assessment which is disputed by the assessee, insofar as such amount does not relate to any rectification of arithmetical errors in the return, accounts and documents. Further, no interest shall be chargeable under Section 220(2) in respect of such disputed amount.

2. Whether a summary assessment has been made or not, in cases where the I.T.O., considers it necessary or expedient to verify the correctness or otherwise of the return, he may require the presence of the assessee and or the production of evidence by issue of notice under Section 143(2). But, if a summary assessment has already been made and the assessee has applied for reopening of assessment, the I.T.O. can do so only with the previous approval of the Inspecting Assistant Commissioner.

3. A summary assessment can be reopened and a regular assessment under Section 143(3) can be made only in cases where the return is incorrect, inadequate, or incomplete. For this purpose a summary assessment *shall be deemed* to be incorrect, inadequate or incomplete in any material respect if :

(a) the amount of total income on which the summary assessment has been made is greater or smaller than the amount of the total income on which the assessee is properly chargeable to tax ; or

(b) the amount of the tax payable under the summary assessment is greater or smaller than the amount of tax properly payable ; or

(c) the amount of any loss as determined in the summany assessment is greater or smaller than the amount of loss, if any, determinable on a proper computation : or

(d) the amount of any depreciation allowance, development rebate or any other allowance or deduction as determined on summary assessment is greater or smaller than the amount of the allowance or deduction properly allowable ; or

(e) the amount of the refund as determined under the summary assessment is greater or smaller than the amount of the refund or deduction properly allowable : or

(f) the statea in which the assessae has been assessed under the summary assessment is different from the status in which the assessee is properly assessable under the Act. For this purpose the term "status" means the classification of the assessee as an individual, Hindu undivided family or any other category of persons specified in Section 2(31) and, where the assessee is a firm, its classification as a registered firm or an unregistered firm.

4. After hearing such evidence as the assessee may produce and such other evidence as the I.T.O. may require on specified points. and after taking into account all the relevant material which he has gathered :

(i) where, no summary assessment has been made, the I.T.O. shall make an assessment of the total income or loss of the assessee and determine the sum payable by him or refundable to him ;

(ii) where, a summary asssessment has already been made and the I.T.O. is of the opinion that such an assessment is incorrect, incomplete or inadequate in any material respect, the I.T.O. shall, by an order in writing make a fresh assessment of the total income or loss of the assessee and determine the sums payable by him or returnable to him on the basis of such assessment [Section 143(3)].

The assessee is *not* entitled to proceed on appeal on the basis of a provisional assessment for refund under Section 141A or a summary assessment under Section 143(1). But an appeal can be made on the basis of a regular assessment Section 143(3) after reopening a summary assessment made under under Section 143(1) and from a regular assessment after a notice issued under Section 143(2) and/or 142(1).

Where an assessment is so made in the case of an assessee, which is a firm which has been registered or whose registration has been effected under Section 184(7) for any assessment year, the Income-tax Officer, under Section 186(2), may also, *at* his discretion cancel the regitration of the firm for the relevant asssessment year. However, the registration will not be cancelled without giving the firm a notice of not less than 14 days, intimating his intention to cancel the registration and giving the assessee a reasonable opportunito of being heare. Where the registration of firm is cancelled for any assessment year, the Income-tax Officer shall amend the assessment of the firm and its partners in respact of that assessment pear on the footing that the firm is an unregistered ffrm. It may also be noted that in any of the three contingencies mentioned in Section 144 where a best judgment assessment has to be made in the case of a firm, the Income-tax Officer, may at his discretion, refuse to register the firm under Section 185(5).

The Income-tax Officer, under Section 145(2), is also empowered to make a best judgment assessment in certain cases notwithstanding the absence of any of the defaults on the part of the assessee of the nature referred to in Section 144. Such cases are :

(i) where the Income-tax Officer is not satisfied about the correctness or completeness of the accounts :

(ii) where no method of accounting has been regularly employed by the assessee.

In these cases also the Income-tax Officer, at his *discretion*, can make a best judgment assessment. But such a best judgment assessment is not an *exparte* assessment and, therefore, for its cancellation no provision has been made in the Act. However, it is open to the assessee to file an appeal against such an assessment to the Appellate Assistant Commissioner of Income-tax under Section 246. But in these two cases even if the I.T.O. makes a best judgment assessment on firm, he has no power on that account to refuse to register the firm under Section 185(5) or to cancel its registration under Section 186(2).

Cancellation of best Judgment Assessment (Section 146) : When an *exparte* assessment has been made under Section 144 of the Act for any of the reasons mentioned in the preceding paragraphs, under Section 146 the assessee may make an application to the Income-tax Officer, within one month from the date of service of the notice of demand issued in consequence of such an assessment for the cancellation of the *exparte* assessment on any one of the following grounds *viz.*

(i) that he was prevented by sufficient cause from furnishing the return required under Section 139(2) ; or

(ii) that he did not receive the notice under Section 142(1) or 149(2A) or under Section 143 (2) ; or

(iii) that he had no reasonable opportunity to comply with or was prevented by sufficient cause from complying with any of the terms of the notice referred to in (ii) above.

If the Income-tax Officer is satisfied that any or all of the aforementioned grounds exist, he shall cancel the assessment and proceed to make fresh assessment under Section 143 or 144.

This is a case of reopening assessment at the instance of the assessee resulting in the cancellation of best judgment assessment and making a fresh reassessment. Cases falling under Section 145 (2) stated above in which the I.T.O. has the discretion to make a best judgment assessment do not fall within the provisions of this Section and consequently the order to best judgment assessment in those cases cannot be cancelled by the I.T.O. The assessee, however has the

right to appeal against the order of best judgment assessment in addition to the right to apply for the cancellation of the assessment under this Section.

There is a time limit of 90 days within which the Income-tax Officer has to dispose of the application received by him under Section 146(1) for the reopening of assessment of any tax payer, where a best judgment assessment had already been completed. However, for computing this limit of 90 days, the delay in disposing of the application, which is solely attributable to the assessee must be excluded.

Additional Powers of Inspecting Assistant Commissioners Regarding Assessments : (144A 144B) :

Under Section 144A, an Inspecting Assistant Commissioner is entitled on his own motion or on the basis of a reference made to him by the Income-tax Officer or even on receipt of an application from the assessee, to call for and examine the records of any proceedings in which an assessment is pending and, if he considers that having due regard to the nature of the case and the amount involved or for any other reason, it is necessary or expedient so to do, he may issue such directions as he deems fit for the guidance of the Income-tax Officer in order to enable him to complete the assessment. Any such direction and instruction issued by the Inspecting Assistant Commissioner is binding on the Income-tax Officer. However, in every case, where the order or direction sought to be issued by the Inspecting Assistant Commissioner is prejudicial to the assessee, the assessee must be given a reasonable opportunity of being heard before the directions are issued. But any direction issued by the Inpecting Assistant Commissioner as to the lines on which an investigation connected with the assessment must be carried out, shall not be deemed to be prejudicial to the assessee. This power of the Inspecting Assistant Commissioner is exercisable by him over and above the other powers specified in Section 119(3).

Draft Assessment order :

Under Section 144B the Inspecting Assistant Commissioner has been empowered to make orders of assessment in certain cases. According to this provision in cases where, in any assessment to be made under Section 143(3), the Income-tax Officer proposes to make any variation in the income or loss returned by the assessee, such variation being prejudicial to the assessee and the amount of such variation sought to be made, exceeds the amount prescribed for this propose by the Board, the Income-tax Officer is obliged, in the first instance, to forward a draft of the assessment order proposed to be made by him to the assessee before passing the final assessment order. On receipt of the draft order, the assessee in entitled to forward his objections, if any, to the variations sought to be made by the Income-tax Officer within seven days from the date of receipt by him of

the draft order or within such further period as may be allowed by the Income-tax Officer on receipt of an application from the assessee made to him in this behalf. In any case, the time-limit for forwarding the objections should not exceed fifteen days of the receipt of the original draft order.

In cases, where no objections are received within the period of seven days or within the extended period as aforesaid or in cases, where the assessee intimates to the Income-tax Officer the acceptance of the variation, the Income-tax Offieer would be entitled to complete the assessment on the basis of the draft order originally issued by him to the assessee. Where, any objections are received, the Income-tax Officer is required to forward the draft order together with the objection raised by the assessee to the Inspecting Assistant Commissioner and the Inspecting Assistant Commissioner should, after considering the draft order passed by the Income-tax Officer and the objections raised by the assessee and after going through, whereever necessary, the relevant records relating to the draft order, issue such directions as he would deem fit in respect of the matters covered by the objections raised by the assessee. The directions issued by. Inspecting Assistant Commissioner should be the basis on which the Income-tax Officer should proceed to complet the assessment. However, if the Inspecting Assistant Commissioner proposes to give any direction which is prejudicial to the interests of the assessee, he must give him a reasonable opportunity of being heard before issuing his directions. Every direction issued by the Inspecting Assistant Commissioner on the basis of the draft order and the objections raised by the assessee would be binding on the Income-tax Officer. It was held in Sudhir Sareen v I.T.O. 128 I.T.R. 445 tnat the Section (144B) does not permit the I.T.O. to make more than one draft assessment order.

The Central Board of Direct Taxes has been empowered, for the purposes of enabling the Income-tax Officer and the Inspecting Assistant Commissioner to apply the provisions of Section 144B, to fix such amount as it deems fit so that any variation to the income or loss returned by the assessee exceeding the amount so fixed by the Board would be a case, in which the Inspecting Assistant Commissioner would have the power to make orders of assessment under the new Section. This power of the Board should be exercised having due regard to the proper and efficient management of the work of assessment and the Board is empowered not only to prescribe the amount, but also to vary the same from time to time as it deems fit. The Board has been specifically empowered to prescribe different amounts for different areas. However, the amount fixed by the Board in exercise of this power shall not in any case be less than Rs. 25,000.

In cases where the Inspecting Assistant Commissioner exercises the powers and performs the functions of the Income-tax Officer in pursuance of the order made by Commissioner under Section 125 or 125A the Inspecting Assistant Commissioner would not, however, be entitled to exercise the powers conferred

on him under this new Section 144B. In other words, wherever, the Income-tax Officer and the Inspecting Assistant Commissioner exercise their powers and have concurrent jurisdiction over the same assessee, the powers and functions of the Income-tax Officer and the Inspecting Assistant Commissioner, contained under this new Section would not be operative.

Method of accounting : *General* : 1. Section 145 deals with the method of computation of income under the following two heads of income. "Profits and Gains of business or profession" and "Income from other sources".

2. It does not apply to other heads of income—viz. "salaries", "interest on securities", "capital gains" or "income from property".

3. Where the assessee has employed a regular method and the income can be properly deduced therefrom his income *shall be computed in accordance with that method.*

4. Where the accounts are correct and complete but the method of accounting employed by the assessee is such that the income cannot properly be deduced therefrom then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine.

5. Where the accounts are not correct or complete or where no method of accounting has been regularly employed by the assessee, the Income-tax Officer *may make a best judgment assessment.* The use of the word "may" in Section 145(2) makes it clear that in such cases a best judgment assessment is not compulsory on the Income-tax Officer.

Accepted methods of accounting : Under Section 5 profits are chargeable when they *accrue* or *arise* or are *received.* The effect of this section is that the assessee's choice of the system of accounting determines whether profits are to be actually charged when they accrue or when they are received or at some other point of time. If the assessee's accounts are kept on the mercantile basis the income would be taxable when it accrues or is earned, irrespective of receipt, the charge being on the net "book profits". On the other hund, if the accounts are maintained on the cash basis income would be chargeable only if it is *received* in the accounting year.

Thus we can perceive that two methods of accounting have been recognised by the Income-tax Act. It is also permissible to follow a hybrid system of accounting.

Regularly followed : The computation of income may be made on the basis of the method of accounting regularly adopted by the assessee. That the regular method is unscientific, or anomalous does not matter for the purpose of this section which only requires the method to be such that the real income, profits and gains can be properly deduced therefrom. The name by which a method is called is an immaterial consideration and it is equally immaterial

whether the system adopted by the assessee conforms to the requirements of a known method of accounting. Conversely, even if the method regularly adopted by the assessee is a well-recognised method of accounting—e.g. the LIFO system of valuation of stock—it should still be rejected by the I.T.O. if it does not afford a true picture of the profits in any one year of charge. New theories of accountancy though accepted for business purposes might not necessarily determine income for tax purposes.

Method of accounting and ambit of taxation : Under Section 145 the assessee's regular method of accounting determines the mode of *computing* the taxable income, but it does not determine or even effect the range of taxable income or the *ambit of taxation*. In other words, the change on income accruing or received in India, imposed by Section 5, cannot be avoided by any method of accounting. For instance a nonresident who might be assessable in respect of stray items of income accruing or received in India cannot escape the charge on income received in India on the ground that his regular method of accounting is mercantile.

Casual departure and bona fide change in the method of accounting : Having adopted a regular method of accounting, the assessee cannot be allowed to change it or depart from it for a particular year or for a part of the year or in respect of particular transactions. However, it is open to an assessee to make a clean change of the regular method adopted by him upto that time, provided he satisfies the department on proper evidence that he has in fact changed the regular basis of accounting and has not merely abandoned or changed it for a casual period to suit his own purposes.

An assessee is entitled to change his regular method of accounting by another regular method and such a change can be effected in respect of a part of the assessee's income [Snow White Food Product Co. Ltd. v CIT (No. 2) 1983, 141 I.T.R. 847]. Where it is found that if an assessee has changed his regular method of accounting by another recognised method and has followed the latter method regularly thereafter it is not open to the revenue authorities to go into the question of bona-fides of the introduction and continuance, of the change. Only in the year where a change in the method of accounting is introduced for the first time, it is to be examined by the revenue authorities, whether the change introduced is meant to be regularly followed. The Calcutta High Court held in Seth Chemical Works *v.* C.I.T. (1983) 140 I.T.R. 507 that where an assessee is allowed to change his method of accounting from an assessment year, he is entitled to claim computation of income on the changed basis only and not on the old basis.

In a case where an assessee makes an application for a change of system, the I.T.O. allows it obviously on being satisfied with the bona fides of the assessee. However mere non-making of an application could not result in drawing an

inference that the switch over was other than bona-fide [Dr. Gshwari Prasad v C.I.T. (1983) 143 I.T.R. 789(All)].

In C.I.T. v Carborandum Universal Limited (1984) 16 Taxman 25, a company was regularly valuing its stock under total cost method, which excluded certain expenses which were to be included under the former method. The change was bona fide and was intended to be followed by the company consistently in the future. The company wanted to apply the new method in the first year of adoption *for valuation of closing stock only* and retain the valuation of opening stock of the relevant year as per the old method. This was of course detrimental to the revenue in that year. The question as to whether the company could do so went before the Madras High Court. It was held that (i) since the change in the method of valuation of stock was bona fide and intended to be followed year after year the company was entitled to change the method of valuation, (ii) merely because the change was detrimental to the revenue, the assessee could not be denied the right to change since this detriment would be ironed out in the coming years, (iii) if the assessee was forced to apply the new method of valuation to the opening stock also then, it will mean change in the valuation of previous year's closing stock and so on necessitating the modification of assessments. This in effect would mean that the assessee would not be able to change the method at all, (iv) so long as the method of valuation adopted by the assessee got recognition from the practising accountants and the commercial world, the adoption of that method could not be quashed by the revenue unless the adoption of that method was found to be not bona fide or restricted for a particular year.

Year in which sales tax, excise etc. are deductible : The decision of the Supreme Court in Kedarnath Jute Mfg. Co. Ltd. v C.I.T. (82 I.T.R. 363) establishes that under the mercantile system of accounting a fiscal liability under a statute should be allowed as a deduction in the year in which the relevant transactions take place although (i) this precise quantification of the liability in the form of an assessment and demand may come later (ii) the assessee may contest the liability in appeal or other proceedings and (iii) the assessee may have made no provision for the liability in his books.

The Finance Act 1983 has inserted a new Section 43B w.e.f. 1.4.84 which inter alia provides that any sum payable by the assessee by way of tax or duty under any law for the time being in force shall be allowed as a deduction only in that previous year in which the sum is actually paid by him. Thus the decision of the Supreme Court as mentioned above has been nullified by the insertion of Section 43B.

Valuation of stock in trade :

Income-tax law recognises *only* the following *two* methods of valuation of

stock ; *viz* (i) valuation of stock consistently at cost regardless of the market price or (ii) valuation at cost or market price whichever is less. The methods which are specially disapproved by the Courts are ; (i) Base stock method, (ii) Last in First out method, (iii) Replacement price, (iv) *Ad hoc* or arbitrary valuation and (v) under valuation, Articles which are saleable only in foreign markets can be valued at *nil*. But in such cases the assessee is even bound to show to the authorities that he had made all the necessary efforts to sell the goods in other foreign markets or in the local market before valuing the stock at *nil*. On dissolution of a firm the stock in hand must be valued at the market price even if the firm had been consistently valuing its stock at the cost and one of the partners takes it over at the cost price. Capital investments which are converted into stock in trade must be valued at their market value on the date of conversion and not at their original cost at the time of conversion : for this purpose it is immaterial, whether the assessee follows the system of valuing his stock at cost or at the lower of cost or market price. Stock withdrawn from the business should be valued at cost. Even in respect of shares and securities held as stock-in-trade the aforesaid principles would apply ; but in the case of bonus shares their cost should not be taken as *nil* merely because the assessee does not pay for these shares at the time of their issue. Cost of bonus shares should, if they rank *pari passu*, be ascertained by averaging *i.e.*, by spreading the cost of the original shares over the original shares and the bonus shares taken together.

An assessee, however, is entitled to change the method of valuation of stock subject to the following conditions being fulfilled *viz.*, (i) the change must be *bona-fide* ; (ii) the new method is followed regularly and consistently in the subsequent years ; (iii) the method adopted as a result of the change is not disapproved by the Courts and (iv) the change is not merely for a particular year.

INCOME ESCAPING ASSESSMENT (Sections 147 to 152)

Circumstances in which Income is said to have Escaped Assessment : It may be recalled that a notice under Section 139(2) of the Act requiring an assessee to make a return of his total income for any assessment year can be issued only during the assessment year and not at any time after the end of the assessment year; also that it can be issued only in a case where the assessee has not submitted a return of his total income voluntarily. It is quite possible that the assessee may have neither filed voluntarily a return of his total income for an assessment year nor a notice under Section 139(2) may have been served upon him to make a return of histotal income for the assessment year although the assessee is chargeable to income tax in respect of that year. Cases also may arise where it is discovered that the assessment was at too low a rate or was an assessment in which excessive loss or depreciation allowance had been computed. In order to guard against the loss of

revenue that may arise in such cases, Section 147 provides for the assessment or reassessment of the income which had escaped assessment on the first occasion. Thus, income would be said to have escaped assessment where no assessment was made and where it was under assessed for any reason.

If a particular income was not included in the relevant accounting year, it can be charged to tax in a subsequent year only by taking reassessment proceedings under this Section and not by adding it to the total income of any other accounting year. The assessment of escaped income must be made as if it were made in the relevant assessment year. The assessment should be based upon the provisions of the Act as they stood in the year in which the income ought to have been assessed. The rates of tax to be applied are those at which the income would have been assessed if the income had not escaped assessment. The assessment, however, should be completed within the time limits prescribed under Section 153(2). Reassessment proceedings may be taken more than once under this section in respect of the same assessee for the same assessment year.

An assessment or reassessment, as the case may be, may be made in the following circumstances :

(a) the Income-tax Officer has reason to believe that taxable income has escaped assessment by reason of any omission or failure on the part of the assessee (i) to make a return of his income under Section 139 for any assessment year, or (ii) to disclose fully and truly all material facts necessary for his assessment for that year ; or

(b) the Income-tax Officer, in consequence of any information in his possession, has reason to believe that the income chargeable to tax has escaped assessment for any assessment year even if there is no omission or failure on the part of the assessee.

Explanation 1 to Section 147 of the Act clarifies that the following shall also be deemed to be cases where income chargeable to tax has escaped assessment :

(a) where the income chargeable to tax has been under assessed :

(b) where such income has been assessed at too low a rate ;

(c) where such income has been made the subject of an excessive relief under the Income-tax Act 1961 or under the Indian Income-tax Act, 1922 ; or

(d) where excessive loss or depreciation allowance has been computed.

The two conditions which must be satisfied before the Income-tax Officer can invoke the pravisions of Section 147 (a) : are (i) The Income-tax Officer must have *'reason to believe'* that income chargeable to tax had escaped assessment. The belief which prompts an Income-tax Officer to apply Section 147 (a) to any particular case must be that of an honest and reasonable person based upon reaso-

nable grounds, and that the Income-tax Officer may act under this Section on direct or circumstantial evidence but not on a mere suspicion, gossip or rumour. These powers of the I.T.O. are wide, but not plenary in nature. Care must be taken to note that the words used in the Section are 'reason to believe' and not 'reason to suspect'. Although the assessee is entitled to challenge the existence of the belief, the assessee cannot question the adequacy of sufficiency of the grounds or reasons on which the I.T.O. came to the belief. The expression 'reason to believe' does not, however, mean a purely subjective satisfaction on the part of the I.T.O. The belief must be held in good faith : it cannot be a mere pretence. It is open to the Court to examine whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and or not extraneous or irrelevant to the purpose ot the Section. There is no requirement in any of the provisions of the Act or under any Section laying down as a condition for the initiation of the proceeding that the reasons which induced the I.T.O. to issue the notice must also be communicated to the assessee. Therefore the I.T.O. need not communicate to the assessee the reasons, which led him to initiate the proceedings under Section 147.

(ii) The second condition is that the I.T.O. must have reason to believe that the escapement of the income from tax is *by reason of* or as a result of either (a) omission or failure on the part of the assessee to make a return of his income or (b) omission or failure on the part of the assessee to disclose fully and truly all the material facts necessary for his assessment for that year. The omission or failure specified in the Section refers only to the material facts within the knowledge of the assessee at the point of time. The expression material facts refers to primary facts necessary for the purpose of the assessment such as the 'residential status, of the assessee' whether individual, company H.U.F. *etc.* and the sources of income. In view of the requirements stated above the provisions of Section 147(a) would apply only if there is concealment of income by the assessee by virtue of his own omission or failure.

Section 147 (b) covers all those cases where the escapement of income is not the result of any omission or failure on part of the assessee to disclose fully and truly all material facts necessary for the purpose of his assessment. For instance, income would be said to have escaped assessment within the meaning of Section 147 (b) if a nonagricultural income was wrongly or by mistake exempt from tax as being agricultural income and the Court subsquently holds that the income is not agricultural or an item of capital expenditure was by mistake allowed to be deducted as revenue expense and later on it was found that the expenditure in question is of a capital nature. Even in case of reassessment made under Section 147 (b) all the following three conditions must be fulfilled before the section can be invoked *viz.* (i) The I.T.O. must have *reason to believe* that the income has escaped assessment. (ii) The belief must be in consequence

of some *information*. (iii) The information must have been received by him *after* the completion of the original assessment.

The 'information' and 'reason to believe' constitute the essential requisite and the basic foundation to set in motion the machinery for assessment under Section 147 (b). This is because of the fact that the I.T.O. has no jurisdiction to start upon a venture of reassessment in a haphazard fashion on a mere suspicion on the hope of unearthing an escapement of tax. Likewise, no action can be taken by the I.T.O. to make a reassessment on the ground of a mere change of opinion in regard to the chargeability to tax of a particular item of income of the allowability of expenditure. But judicial pronouncements as to the true state or meaning and interpretation of law freshly derived from an external source of an authoritative character constitute information within the meaning of Section 147 (b). Therefore, the I.T.O. can make a reassessment on the basis of a subsequeut decision of the Court. While it is generally necessary that the information must have come into the possession of the I.T.O. after the completion of the original assessment, even if the information be such that it could have been obtained during the previous assessment from an investigation of the materials or the records on the facts disclossd thereby or from other enquiry of research into the facts or law, but was not obtained, the jurisdiction of the I.T.O. is not affected.

Issue of Notice (Section 148) : Before proceeding to take action under Section 147, the Income-tax Officer *must* serve on the assessee a valid notice, as provided for in Section 147, containing all or any of the requirements of a notice under Section 139 (2). Moreover, in each case, the Income-tax Officer must record his reasons for issuing a notice under Section 148 before he actually does so.

Time-limit (Section 149) : The following time-limits have been laid down for the issue of a notice under Section 148.

(a) For years from the end of the assessment year, where the assessment or reassessment is to be made on the basis of certain information in the possession of the Income-tax Officer, which had led him to believe that income chargeable to tax had escaped assessment *but there had been no failure* to file the return or concealment on the part of the assessee ;

(b) Eight years from the end of the relevant assessment year [provided the case does not fall under sub-para (c) below] where the income had escape assessment by reason of certain omission or failure on the part of the assessee to make a return of his income for that year ; and

(c) Sixteen years from the end of the relevant year, where the income, which has escaped assessment for reasons mentioned in sub-para (1), amounts to, or is likely to amount to Rs. 50,000 or more for the assessment year in which it has escaped assessment.

The period during which a notice can be issued under Section 148 for assessing or reassessing the income which escaped assessment is much less, where the person, on whom the assessment or reassessment is to be made, is the agent of a non-resident person. In such a case, the notice cannot be issued for any assessment year after the expiry of a period of two years from the end of the relevant assessment year in which the income has escaped assessment.

Sanction for Issue of Notice (Section 151). The period of limitation as aforesaid, begins to run from the end of relevant assessment year and not the accounting years. In any case, where a notice under Section 148 is issued after the expiry of four years from the end of relevant year for which the Income had escaped assessment, the Commissioner has to certify, on the basis of reason recorded by the Income-tax Officer, that it is a fit case for issue of the notice. Similarly, where the notice is issued after the expiry of 8 years from the end of the relevant assessment year in which the income had escaped assessment the Central Board of Direct Taxes has to certify, on the grounds recorded by the Income tax Officer, that it is a fit case for the issue of a notice.

Provision for Cases where the Assessment is in Pursuance of an Order on Appeal etc., (Section 150) : There is, however, no time-limit for issuing a notice under Section 148 for assessing or reassessing the income which has escaped assessment where such an assessment or reassessment is the result of, or is to be made for, giving effect to any finding or direction contained in any order passed by any authority in any proceedings under the Income-tax Act by way of appeal, reference or revision. This unrestricted time-limit, however, shall not apply in any case, where the assessment or reassessment, referred to above relates to an assessment year in respect of which the assessment of reassessment could not have been made at the time the order was made, which was the subject matter of appeal, reference or revision as the case may be, by reason of any other provision limiting the time within which any action for assessment may be taken. For example if the assessment for year 1983-84 is made on 30th June, 1984, on that date the assessment for 1977-78 is ordinarily time-barred. A finding in the appeal against the assessment for the year 1983-84 will not entitle the I.T.O. to initiate proceedings for the assessment year 1977-78 even if the finding clearly indicates that some income includible in the assessment for that year had eacaped assessment.

Other Provisions (Section 152) : When an income which has escaped assessment is assessed under Section 147 the income tax due from the assessee shall be charged at the rate or rates at which it would have been charged had the income not escaped assessment. In cases, where the assessment is reopened under the circumstances specified in Sectian 147(b) if the assessee has not already appealed against the order under Sections 246 to 248, or 264, he is entitled to

claim that the proceedings taken against him may be dropped, provided he is in a position to prove that he had been assessed on an amount or to a sum not less than what he was actually liable even after the income alleged to have escaped tax was taken into account or the assessment or computation had been properly made. But in doing so the assessee would not be entitled to have reopened those matters which have been concluded by an order in appeal, reference, revision or rectification. This is made clear in Section 152(2).

Principles emerging from Relevant court cases : In view of the fact that reassessment proceedings lend themselves to unending litigations we have given below some principles emerging from court cases which will help the students to have a better understanding of the law on the subject. The extracts have been grouped under three heads viz. (1) General Principles, (2) Failure to disclose material facts, (3) Information that income has escaped assessment.

General Principles : (a) Once assessment is reopened by issuing a notice under Section 148 the previous under assessment is set aside and the whole assessment proceedings start afresh. Once valid reassessment proceedings are started, the I.T.O. not only has the jurisdiction but it is his duty to levy tax on the entire income that had escaped assessment during that year.

(b) The words "reason to believe" suggest that the belief must be that of an honest and reasonable person based upon reasonable grounds and that the I.T.O may act on direct or circumstantial evidence but on mere suspicion, gossip of rumour.

The I.T.O. would be acting without jurisdiction if the reason for his belier that the conditions are satisfied does not exist or is not material or relevant to the belief required by the section. The court can always examine this aspect though the declaration or sufficiency the reasons for the belief cannot be investigated by the court.

(c) Where in respect of any year a return has been voluntarily submitted before a ·essment, the Income-tax Officer cannot choose to ignore the return and any noti:: of assessment and consequent assessment under Section 147 ignoring the retur is invalid.

(d) Income which has been duly returned for assessment cannot be said to have escaped assessment within Section 147 though it has not been taxed within the assessment year. The words "has escaped assessment" in Section 147 cannot be read as equivalent to "has not beeen assessed".

(e) The principle that the I.T.O. cannot ignore a voluntary return filed by the assessee and issue a notice of reassessment under Section 147 of the Income-tax Act has no application to cases where a return has been filed by the assessee and assessment made thereon and, thereafter, apprehending proceeding under Section

147 the assessee files another return. Unless a notice of reassessment is issued by the Income-tax Officer, the assessee cannot, after an order of assessment is made, submit a return of his income for the year for which he is already assessed and call upon the I.T.O. to assess his income. Such a proceeding would be futile. It is true that a notice under section 147 is also a notice of assessment and the assessee may furnish a revised return pursuaut to such a notice. However, he cannot seek to rectify his return on which asssessment has already been made. The Income-tax Act does not provide for any machinery for dealing with voluntary return filed by an assessee after assessment of the income for the year of assessment is completed such a voluntary return does not operate as a bar to the Income-tax Officer issuing a notice of reassessment.

(f) Once there exist reasonable grounds for the I.T.O. to form the belief contemplated by Section 147(a) of the Act, that would be sufficient to clothe him with jurisdiction to issue notice. Whether the grounds are adequate or not, is not a matter for the court to investigate. The sufficiency of grounds which induce the I.T.O. is, therefore, not a judicial issue.

(g) The High Court exercising jurisdiction under Article 226 of the constitution has power to set aside a notice issued under Section 147 (b) of the Income-tax Act, 1961 if the condition precedent to the exercise of the jurisdiction does not exist. The court, may, in exercise of its powers, ascertain whether the ITO had in his possession, information, the court may also determine whether from the information, the ITO may have reason to believe the income chargeable to tax has escaped assessments. But the jurisdiction of the court extends no further. Whether on the information in his possession he should commence proceedings for assessment or reassessment, must be decided by the ITO and not by the High Court.

The ITO alone is entrusted with the power to administer the Act; if he had information from which, it may be said, *prima facie*, that he had reason to believe that income chargeable to tax had escaped assessment it is not open to the High Court exercising powers under Article 226 of the constitution to set aside or vacate the notice for reassessment on a reapprisal the evidence. In a petition under Article 226 of the constitution the tax payer may challenge the validity of a notice under Section 147 of the Act on the ground that either of the conditions precedant do not exist, but an investigation whether the inferences raised by the ITO are "correct or proper" cannont be made.

Failure to disclose material facts : (a) The reasons for the formation of the belief contemplated by Section 147 (a) for the reopening of an assessment must have a rational connection or relevant bearing on the formation of the belief. Rational connection postulates that there must be a direct nexus or link between the material coming to the notice of the Income-tax Officer and the formation of

his belief that there has been escapement of the income of the assessee from assessment in the particular year because of his failure to disclose fully and truly all material facts. It is not any and every material, howsoever, vague and indefinite or distant, remote and far-fetched which would warrant the formation of the belief relating to escapement of the income of the assessee from assessment.

(b) The ITO need not communicate to the assessee the reasons which led him to initiate the proceedings under Section 147.

(c) The mere production of evidence before the ITO is not enough and there may be an omission or failure to make a full and true disclosure, if some material for assessment lies imbedded in that evidence which the assessee can uncover but does not. If there is such a fact, it is the duty of the assessee to disclose it. Thus, questions of status, agency, the benami natur of transactions, the nature of trading and like matters may not appear from the evidence produced unless disclosed.

If it be merely a question of interpretation of evidence by an ITO from whom nothing has been hidden and to whom everything has been fully disclosed, then the assessee cannot be subjected to Section 147 merely because the ITO miscarried in his interpretation of evidence. But it is otherwise if a contention which is *contrary of fact* is raised and the ITO is set to discover the hidden truth for himself: In the latter case there is suppression of material facts or in other words, that lack of full and true disclosure which would entitle action nnder Section 147 of the Act.

(d) The assessee is not entitled to be given a copy of the reasons recorded by the ITO for the issue of a notice under Section 148.

3. **Information that income has escaped assessment :** (a) Two conditions are necessary for invoking Section 147 (b) (1) The officer should receive information after the original assessment (2) In consequence of such information he should have reason to believe that income has escaped assessment. The information' may be of 'facts' or of 'law'. The "information" of a fact may be from external source. The fact that the ITO with diligence could have obtained the information during the previous assessment on a proper investigation of the materials on the record or the facts disclosed thereby, would not make it any the less information if the fact was not in fact obtained and came to his knowledge only subsequently. So also the fact that on a research as to the state of law the ITO would have ascertained the true legal position would not make any difference if the officer came to know the real position of the law only subsequently. The words "external source" cannot be construed as implying that the source must be outside the record. The information may be gathered from the assessment record itself.

(b) The fact that the successor of the Income-tax Officer who had made the original assessment has changed his opinion does not furnish a justifiabe reason for taking action under Section 147.

(c) The opinion of an internal audit party of the income-tax department on a point of law cannot be regarded as "information" within the meanin g of Section 147 (b) of the Act, for the purpose of reopening an assessment. But although an audit party does not possess the power to pronounce on the law, it nevertheless may draw the attention of the ITO to it. Law is one thing and its communication another. If the distinction between the source of the law and the communication of the law is carefully maintained, the confusion which often results in applying Section 147 (be) may be avoided. While the law may be enacted or laid down only by a person or body with authority in that behalf, the knowledge or awareness of the law may be communicated by anyone. No authority is required for the purpose. That part alone of the note of an audit party which mentions the law which escaped the notice of the ITO constitutes "information" within the meaning of Section 147 (b) ; the part which embodies the opinion of the audit party in regard to the application or interpretation of the law cannot be taken into account by the ITO. [Indian Eastern Newspaper society v. CIT (1979) 119 ITR 996 (SC)]

(D) TIME-LIMITS FOR ASSESSMENT OR REASSESSMENT

Under Section 153 the following time-limits have been prescribed for completion of assessment or reassessments made under Section 143, 144 and 147.

(A) (a) Where the assessment is a regular assessment under Sections 143 or a best judgment assessment under Section 144, it must be completed before the expiry of :

(i) four years from the end of the assessment year in which the income was first assessable, where the assessment year in question is 1967-68 or any earlier year ;

(ii) three years from the end of the assessment year in which the income was first assessable, where the assessment year is 1968-69 ;

(iii) two years from the end of the assessment year in which the income was first assessable where such an assessment year is 1969-70, or any subsequent year ;

(b) eight years from the end of the assessment year in which the income was first assessable in cases, where the assessee had concealed particulars of his income or had furnished inaccurate particulars ; or

(c) one year from the date of filing of a belated return or a revised return under section 139(4) or 139(5) ;

whichever is the latest

It is apparent from the above that when the assessment to be made is an ordinary assessment on the first occasion, normally the time-limit specified in (A) above will operate depending upon the date on which the assessment year commences. If, it is established that it is a case in which the assessee has concealed the income or deliberately furnished inaccurate particulars of such income, the time-limit will be extended to 8 years. To cover cases, where a person furnishes a return just toward the end of the fourth, third, or the second assessment year, as the case may be, from the end of the assessment year to which the return relates under the right given to him by Section 139(4) or 139(5) of the Income-tax Act a further period of one year is allowed for completing the assessment. It runs from the date the return is furnished.

(B) Where, the assessment is an assessment or recomputation of income which has escaped assessment, falling under Section 147.

(a) 4 years from the end of assessment year in which the notice under Section 148 was served, where the assessment or reassessment to be made under Section 147(a) :

(b) (i) was 4 years from the end of the assessment year in which the income first assessable, where there assessment to be made under Section 147(b) ; or

(ii) one year from the date of service of a notice under Section 148, whichever is *later*.

Under Section 153(2A) even fresh assessments as have to be made within a specified time. Thus, where a fresh assessment to be made under Section 146 (*i.e.*, where an *exparte* assessment has been cancelled by the I.T.O. on receipt of an application from the assessee) or in pursuance of an order setting aside the assessment by the A.A.C. under Section 250 or the Appellate Tribunal under Section 254 or the Commissioner by way of revision under Section 263 or 264 may be completed at any time before the expiry of two years from the end of the financial year in which the order under Section 146 passed by the I.T.O. or the order of the A.A.C., Tribunal or the Commissioner, as the case may be, was passed. Such fresh assessment may be completed within the time-limit of two years aforesaid even if the time limits specified in Section 153(1) and (2) for the completion of assessment or reassessment have expired.

Exception : There is, however, no time-limit, whatsoever, for making an assessment in the following cases :

(i) where a fresh assessment is made under Section 146 ;

(ii) Where the assessment or reassessment is made on the assessed or any other person in consequence of, or to give effect to any finding or direc-

tion contained in any order under Sections 250, 254, 260, 262, 263 or 264 (in appeal, reference or revision) or in order by a Court in a proceeding otherwise than by way of appeal or reference under this Act :

The exceptions in (i) and (ii) above are, however, subject to the provisions of Sub-section (3A) of Section 153, explained earlier.

(iii) where, in the case of a firm, an assessment is made on a partner of the firm in the case of a firm, an assessment of the escaped income is made on the firm under Section 147.

In computing the period of limitation for the purpose of this Section the time taken in reopening the whole or any part of the proceedings, in giving an opportunity to the assessee to be reheard when there is a change in the incumbency of the office or any period during which the assessment proceedings is stayed by an order of the Court shall be excluded.

Similarly, in computing the period of limitation for completion of assessment or reassessment under Section 153 of the Act, the period will exclude the time taken ;

(i) for completion of the special tax audit of the accounts of the assesse under Section 142(2A) :

(ii) for obtaining the direction of the Inspecting Assistant Commissioner under Section 144B ; and

(iii) In case, where an application for settlement of the case has been rejected or is not allowed to proceed with by the Settlement Commission and the date of the order of the Settlement Commission.

Accordingly, the time limits specified in the Section could be taken to have been enlarged to the extent of the time taken in the above circumstances for the purpose of determining the time within which the assessment or reassessment will have to be completed.

Where, by an order in appeal, referenae or revision, any income is excluded from the total incomes of the assessse for any assessment year, then, an assessment of such income for another assessment year shall, for the purpose of Sections 150 and 153, be deemed to be one made in consequence of or to give effect to, any finding or direction contained in the appellate order. Similarly, where, by an order in appeal, reference or revision of any income is excluded from the total income of one person and held to be income of another person, then, an assessment of such income on such other person shall, for the purposes of, Sections 150 and 153, be deemed to be one made in consequence of, or to give effect to, any finding or direction contained in the appellate order. This is, however, subject to the condition that the other person had been given a resonable opportunity of being heard before the appellate order was passed.

RECTIFICATION OF MISTAKES & OTHER PROVISIONS
(Sections 154 to 158)

Rectifications of Mistakes (Section 154): If the Income tax Officer, subsequent to the completion of assessment, finds that it is apparent from the record that a mistake has been committed in any assessment order or refund order passed by him in any case, he may at any time within four years from the date of the assessment or the refund order so passed by him, rectify, *on his own motion*, such a mistake. If the mistake is brought to his notice by the assessee, he shall rectify such a mistake within the like period. In the former case, if the effect of the rectification would be to increase the tax liability of the assessee or to reduce the refund due to him, the rectification shall not be made unless the assessee has been given a notice by the Income-tax Officer of his intention to rectify the mistake and he has been given a reasonable opportunity of being heard in the matter. The power to rectify such mistakes within the limited period is also vested, *mutatis mutandis*, in the Appellate Assistant Commissioner or the Commissioner (Appeals) in respect of orders passed by him under Section 250 and 271; and the Commissioner of Income-tax respect of orders in revision passed by him under Sections 263 and 264. Furthermore, where any matter has been considered and decided in any proceeding by way of an appeal, reference or revision relating to any order in which any mistake is apparent from the record, the authority passing such an order may notwithstanding anything contained in any law for the time being in force, amend the order in relation to any matter notice of which has been so considered and decided if the mistake is brought to the notice of A.A.C. by the I.T.O. the former is bound to rectify the same.

The jurisdiction of any authority under the Act to make an order under Section 153 depends upon the existence of a mistake apparent on the face of the record. It may be a mistake of fact as well as mistake of law. For instance, the treatment of a non-agricultural income as agricultural income and granting exemption in respect of such income is an obvious mistake of law which could be rectified under Section 154. But where, the I.TO. can consider the same matter either as a rectification under Section 154 or as the case of income escaping assessment requiring action under Section 147 (b) he is entitled to decide the provision under which he would reassess the income; but he cannot assess the same item by taking action under both the Sections simultaneously. However, a mere change of opinion cannot be the basis on which the same or the successor I.T.O. can treat a case as one of rectification of mistake. A mistake is one apparent from the record in case, where it is a glaring, obvious, patent or selfevident mistake, which has to be discovered by a long drawn process of reasoning of examination of arguments on points, where there may be two opinions, cannot be said to be mistake or error apparent from the record. A mistake arising as a result jo subsequent interpretation of Law by the Supreme Court would also constitute

error apparent from the record. Retrospective amendment of law could also lead to rectification if an order is plainly and obviously inconsistent with the specific and clear provision, as amended retrospectively.

Where an amendment is made under this Section, an order shall be passed in writing by the authority concerned. Where any such amendment has the effect of reducing the taxable income, the I.T.O. shall make any refund due to assessee subject, however, to the provisions of Section 241 under which the I.T.O is empowered to withhold the refund in certain cases. Where any such amendment has the effect of enhancing the assessment or reducing the refund already made, the I.T.O. shall serve the assessee with a notice of demand in the prescribed form specifying the sum payable. Except in cases which are specifically covered by Section 155 or Section 186(4) dealing with cancellation of registration no amendment under this Section shall be made after the expiry of four years from the date of the order sought to be amended.

Where the registration of a firm is cancelled under Section 186 for any assessment year the I.T.O. shall amend the assessments of the firm and its partners for the assessment year on the footing that the firm is an unregistered firm. Consequently, the provisions of Section 154 shall, so far as may be, apply to the amendments of the assessment of the firm and its partners, the period of four years being reckoned from the date of the order cancelling the registration.

Other Amendments : Under Section 155 amendments are permitted on the ground that the necessity for making the amendment has arisen, but necessarily of a mistake apparent from the record and consequently the provisions of Section 154 can be invoked. The specific purposes for which the advantage of this provision can be taken are :

(i) the amendment of the assessment of a partner of a firm consequent upon the assessment or reassessment or any enhancement or reduction in the income of the firm as a result of any order in appeal, reference, revision or rectification :

(ii) the amendment of the assessment of a member of an association of persons consqueat upon the assessment or reassessment or any enhancement or reduction in the income of the association as a result of an order in appeal, reference, revision or rectification ;

(iii) amendments consquent upon any change or modification on appeal, revision or reference in the amount of excess profits tax or business profits tax payable by the assessee which also affects the computation of the total income for income-tax purposes ;

(iv) amendments resulting from any proceedings initiated under Section 147 on account of recomputation of total income, where excessive loss or

depreciation allowance had been allowed or losses had been set off and carried forward under the different heads ;

(v) recomputation of the total income of the assessee consequent upon the disallowance of the development rebate, investment allowance or development allowance or excess of the expenditure on approved programme of scientific research originally allowed to him but consequently withdrawn on the ground that the prescribed conditions have not been complied with ;

(vi) recomputation of the total income of the assessee of an ealier previous year for allowing deduction in respect of a bad debt on the finding of the Income-tax Officer with respect to a later previous year that the debt became bad in the earlier previous year ;

(vii) recomputation of the distributable income of a company in which the public are not substantially interested which is liable to pay additional incom-tax on its undistributed profits, in whose case an order under Section 104 has been made, consequent upon any proceeding under the Act ;

(viii) amendments resulting in the recomputation of capital gains arising from the transfer of any capital assets being a residential house which was charged to tax under Section 54 if within one year from the date of such transfer, the assessee purchases or, within three years from that date, he constructs a house property for his own residence ;

(ix) amendments resulting in the recomputation on capital gains arising from the transfer of agricultural lands which were charged to tax under Section 54B, if, within two years of the transfer, the assessee acquires land for being used for agricultural purposes ;

(x) amendments resulting in the allowance of exemption under Section 54D in respect of the capital gains arising from the transfer by way of compulsory acquisition of the capital assets of the assessee after the assessee qualifies for the exemption by acquiring any other land or building or constructing any other building within three years of the transfer of the purpose of shifting or re-establishing his industrial undertaking ;

(xi) allowance of deduction under Section 80 N in respect of the dividends from foreign companies after the fulfilment by the assessee of the conditions relating to the conversion of the dividends into convertible foreign exchange and bringing the same subsequently into India ;

(xii) allowance of deduction under Section 80 O in respect of royalties, fees etc., from foreign sources after the fulfilment by the assessee of the condi-

tions relating to the conversion of the royalties *etc*, received in the foreign countries into convertible foreign exchange and bringing the same subsequently inty India ;

(xiii) revocation of the disallowance of provision for gratuity (by whatever name called) for the purpose of allowing deduction subsequently when the moneys are contributed by the employer by way of a transfer to an approved gratuity fund within the time limits specified in Section 40A(7) ;

(xiv) recomputation of capital gains on receipt of additional compensation or consideration under Section 155(7A) ;

(xv) recomputation of capital gain under Section 54 read with Section 155(8A) in cases of compulsory acquisition of house property by the Government ;

(xvi) recomputation of capital gain under Section 54B read with Section 154(9A) in cases of compulsory acquisition of agricultural lands ;

(xvii) recomputation of capital gain in cases of compulsory acquisition of industrial undertakings under Section 54D read with Section 155(10) ; and

(xviii) recomputation of capital gain in cases of compulsory acquisition of capital assets falling under 54E read with Section 155(10B).

(xix) recomputation of capital gain allowed under section 54F read with Section 155(10C).

For the purposes of items (xi) and (xii) above the time limit of four years should be reckoned from the date the dividend royalties fees, etc., are received or brought into India. For the purposes of item (xiii), the time limit of 4 years should be reckoned from the end of the financial year ending 31st March, 1977. For items (xiv) to (xviii), the time limit of four years for purposes of rectification should be reckoned from the end of the financial year in which the additional compensation or additional consideration, as the case may be is received by the assessee.

3. COLLECTION AND RECOVERY OF TAX :

(i) **General** : The Act provides for two modes of collecting taxes—direct levy on the assessees and levy by deduction of tax at source. Direct levy on the assessees is to be made only in cases (i) where the tax is not deductible at source and (ii) where the tax has not, in fact, been deducted at source. If tax has been deducted but not paid to the Central Government, it cannot be once again levied on the assessee who has suffered the deduction. The Act casts an obligation on persons who are making the following types of payments to deduct tax out of the amounts paid in the manner stated below :-

(ii) **Deduction of Tax at source Salaries** : (Section 192) : Every person responsible for paying any income chargeable to tax under the head, salaries, is required to deduct income-tax (including surcharge) on the amount payable at the

average rate of income-tax computed on the basis of the rates in force for the relevant financial year applicable to the estimated total income of the assessee irrespective of the fact whether he is a resident or not-ordinarily resident or non-resident. The employer's liability to deduct tax at source is absolute and is not affected by any private arrangement that may exist between him and the employee whereby the employee has undertaken to discharge his own liability. However, deduction at a rate lower than that prescribed may be made if a certificate has been obtained under Section 197 from the Income-tax Officer. But the failure to deduct tax from salaries disentitles the employer in certain circumstances to any deduction in respect thereof under Section 40 (a) (iii) and 58 (a) (1) (iii).

Every year the Central Board of Direct Taxes issues a Circular after the Finance Bill is introduced in the Parliament giving details and directions to all employers for the purpose of deduction of tax from salaries payable to the employees during the relevant financial year. These instructions should be followed in every case.

In cases where an employee takes up a job with another employer during the financial year after his resignation or retirement from the total service of the former employer, the subsequent employer should ascertain the total remuneration etc., paid by the previous employer and the tax deducted therefrom and then deducted the tax remaining payable in respect of the employee's remuneration from both the employers for the relevant financial year.

The person responsible for making the payment may, at the time of making any deduction, increase or reduce the amount deductible under this Section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year. The obligation to deduct tax at source in respect of payments of the accumulated balance due to an employee (which is not exempt under Rule 8 of Part A of the Fourth Schedule) rests even on the trustees of a recognised provident fund or any person authorised by its regulations. Likewise, an employer must deduct tax at source in respect of payment made to the employees out of an approved superannuation fund representing the employer's contribution together with the interest thereon. (Rule 6 of part B of the Fourth Schedule to the Act).

For purposes of deduction of tax out of salaries payable in a foreign currency the value of salaries in terms of rupees should be calculated at the prescribed rate of exchange as specified in Rule 26 of the Income-tax Rules.

Monthly returns : Persons responsible for paying salaries shall send monthly return in the prescribed forms containing the details of tax deducted at source to the concerned I.T.Os. Where the trustees of an approved superannuation fund pay any contribution by an employer including interest to an employee, they have

lso to send suitable returns to the I.T.O. Apart from this annual returns of alaries laid and tax-deducted source have also to be filed.

Interest on Securities (Section 193) : Every person responsible for paying ny income chargeable under this head shall, at the time of payment, deduct income x at the rates in force from the amount of interest payable.

If the person entitled to receive interest produces a certificate under Section 7 from the Income-tax Officer to the effect that the total income of the payee is ither below the taxable minimum or is liable to income-tax at a lower rate the iterest on securities shall be paid without any deduction being made or after a duction at a lower rate, as the case may be. However, no tax shall be deducted om any interest payable on :—

(i) 4¼% National Defence Bonds, 1972, where the bonds are held by an individual not being a non-resident ; or

(ii) 4¼% National Defence Loan, 1968 or 4¾% National Defence Loan, 1972 where the interest is payable to an individual ;

(iii) National Saving Certificate (First Issue) ;

(iv) 7-year National Savings Certificates (IV) Issue) ;

(v) Debentures issued by any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank) or any other institution or authority, as the Central Government may, by notification in the Official Gazette, specifiy in this behalf ;

(vi) 6½% Gold Bonds, 1977 or 7% Gold Bonds, 1980 where the bonds are held by an individual (other than a non-resident) provided that the holders of the bonds make a declaration that the total nominal value of the bonds held by him or on his behalf did not in either of the above cases exceed Rs. 10,000 at any time during the period to which the interest relates ;

(vii) any other security of the Central or State Government where the security is held by a resident individual provided that he makes a declaration in writing to the effect that :—

(a) he had previously been assessed or was not assessable under the Act :

(b) his total income of the provious year in which the total interest is due is not likely to exceed the maximum amount not chargeable to tax [*i.e.* Rs. 10,000 at present].

(c) the total nominal value of the securities held by him or on his behalf did not exceed Rs. 2,500 at any time during the previous year,

(viii) **Amendment by Finance Act 1984 w.e.f. 1.6.1984**
any interest payable to an individual who is resident in India, on debentures issued by the company in which the public are substantially interested. However

(i) such debentures must be listed in a recognised stock exchange.

(ii) the interest should be paid by the company by an account payee cheque

(iii) the amount of such interest or the total thereof paid or likely to be paid during the financial year should not exceed Rs. 1,000.

(ix) such securities of the Central Government or any State Government to such class of persons and subject to such conditions as may be specified by Central Government.

In all the above cases, the declaration shall be made by the recipient to the person responsible for paying such interest on securities. The CBDT also issues Circulars every year containing instructions in this regard.

Dividends (Section 194) : In the case of dividends, the liability to deduct tax at source arises not only in respect of dividends declared annually or half yearly but also in respect of all the notional dividends as defined in sub-section (22) of Section 2.

Income-tax shall be deducted from all dividends by the principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends including on preference shares within India (discussed in Study Paper V) before making payment thereof in cash or kind or before issuing dividend warrants or cheques.

Exceptions :

(a) Where the shareholder, not being a company, has obtained a certificate from the Income-tax Officer that his income will be below the taxable minimum and as such no tax need be deducted. [Section 197 (1)]

(b) Where the company paying the dividend has obtained a ruling from the Income-tax Officer that the whole or a part of the dividend will be exempt from tax under Section 80 K. [Section 197(3)].

(c) Where the dividend is payable on shares which are owned or beneficially held by the Central Government or the Reserve Bank of India or a Corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income tax on its income [Section 196].

(d) Where dividend is paid by a company in which public are substantially interested by an account payees cheque to shareholder who is a resident individual. The aggregate of such dividends paid or payable in the

financial year should not exceed Rs. 1,000 (effective from 1.6.84).

The tax is to be deducted at the rates in force i.e., at the rates for deduction of tax at source prescribed in part II of the Firt Schedule to the relevant Finance Act [Section 2 (36) (ii)]. The deduction of tax at source should be made even in the cases of preference shareholders who are entitled under the company's Articles of Association to a dividend at a fixed rate free of tax. The deduction of tax under this Section is in respect of the shareholder's tax and not the company's own tax liability in respect of its income which is distributed as dividends.

Under the first Proviso to Section 194 shareholders (other than companies) who are residents in India are entitled to receive their dividends from any domestic company without deduction of tax at source by the company in cases where :—

(i) the amount of dividend income does not exceed Rs. 250 ; *and*

(ii) the shareholder furnishes to the person responsible for paying the dividend a written statement in Form No. 14B (prescribed under Rule 28A of the Income-tax Rules, 1962) and verified in the manner prescribed therein declaring that his estimated total income of the previous year in which such dividend is includible in his total income under the provisions of Section 8 would be less than the basic exemption limit applicable to him.

Wherever the shareholder claims the dividends due to him to be paid without deduction of tax at source as aforesaid, the person responsible for paying dividends is authorised to make the payment to the shareholders without deduction of tax at source. But, the person responsible for paying dividends should, within 30 days from the 31st day of March in each year, furnish to the I.T.O. the return in Form No. 27B (prescribed under Rule 37B) as required under Section 206B giving complete details of dividends paid without deduction of tax ; the return should be verified in the manner prescribed in Form No. 27B.

Further, under Rule 29 of the Income-tax Rules, the I.T.O. may give a certificate authorising the payment of any dividend to shareholder, other than a company, without deduction of tax or, as the case may be, after deduction of tax at rates lower than the rates in force only if the following conditions are satisfied ;

(a) The shares in respect of which certificate is sought for by him—

(i) are shares in public companies ; and

(ii) stand in his name and are beneficially owned by him and the dividends therefrom are not includible in the total income of any other person under Sections 60 to 64 ;

or

stand in his name and are held by him under trust wholly for charitable or religious purposes and the dividends therefrom are

exempt from tax under Sections 11 to 13.

(b) An application for the issue of the certificate is to be made to the I.T.O. in the prescribed form and verified in the prescribed manner.

The certificate is valid for such period, not exceeding three years from the date of its issue, as the I.T.O. may specify therein unless it is cancelled by him at any time before the expiry of the specified period. An application for a fresh certificate may be made, if required by the assessee after the expiry of the period of validity of the earlier certificate. The certificate is valid only for the person named therein and shall cease to be operative from the date of notice of the company of the transfer of any of the shares mentioned therein to another person in respect of the shares so transferred. The certificate shall, in all cases, be issued in Form No. 15 direct to the principal officer of the company under advice to the applicant shareholder.

Under Rule 37 (3) the person responsible for paying dividends to :—

(i) any person, not being a company, who is a non resident or a not ordinary resident ; or

(ii) a company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration and payment of dividends within India.

shall, within 14 days from the date of deduction, send to the I.T.O. having jurisdiction to assess him a statement in Form No. 27 verified in the prescribed manner.

Interest other than interest on securities : Section 194A deals with the scheme of deduction of tax at source from interest other than interest on securities. The main provisions are the following :—

(i) It applies only to interest credited or paid by any assessee other than individuals or Hindu undivided families. In other words, companies, firms, associations of persons, local authorities and artificial juridical persons are under a legal obligation to deduct tax at source in respect of the interest paid by them.

(ii) These provisions apply only to interest paid or credited to resident and not ordinarily resident persons, whether they are assessees under the Act or not. In respect of payment to non residents, the Act already contains special provisions under Section 195.

(iii) The deduction of tax must be made at the time of crediting such interest to the payee or at the time of its payment in cash or by any other mode, whichever is earlier.

(iv) The deduction of tax at source is to be made in all cases where the amount of income by way of interest or as the case may be, the *aggregate*

of the amounts of interest credited or paid or likely to be credited or paid during the *financial year* to the account or of to the payee or any other person on his behalf is Rs. 1,000 or more. Where the interest is paid in cash, the deduction will be made at the time of cash payment. Where the interest is first credited to an account and paid in cash later, the deduction will be made at the time of giving credit to the account.

(v) The rates at which the deduction is to be made are given in Part II of the I Schedule to the Finance Art.

(vi) The deduction need not be made in cases where the person (not being a company or a registered firm) furnishes an affidavit or statement in the prescribed form verified in the prescribed manner declaring that his estimated total income assessable for the next assessment year will be less than the minimum amount liable to tax in his case.

(vii) The statement in writing to be furnished by a person who does not have a taxable income, for the purpose of receiving his interest income without deduction of tax at source should be in Form No. 15A prescribed under Rule 29A and it may be signed in presence of and attested with the official seal by a member of the Parliament or State Legislature, a member of a District Council, Metropolitan Council, Muncipal Corporation of Municipal Committee or an officer of any bank (including a co-operative bank) of the rank of an agent, sub-agent or manager.

(viii) No deduction of tax shall be made in the following cases :—

(a) If the aggregate amount of interest paid or credited during the financial year is less than Rs. 1,000;

(b) Interest paid or credited before 1st October, 1967;

(c) Interest paid or credited by a firm to any of its partners ;

(d) Interest paid or credited by a co-operative society to a member thereof or any other co-operative society;

(e) Interest paid or credited in respect of deposits under any scheme framed by the Central Government and notified by it in this behalf;

(f) Interest income credited or paid in respect of deposits with a bank to which the Banking Regulation Act, 1949 applied or with a co-operative society engaged in carrying on the business of banking including a co-operative land mortgage bank or a co-operative land development bank;

(g) Interest income credited or paid by the Central Government under any provisions of the Income-tax the Act, the Estate Duty Act, the Wealth-tax Act, the Gift-tax Act, the Companies (Profits) Surtax Act or the Interest Tax Act.

(ix) In addition, no tax shall be deducted from the interest paid or credited to the following entities :—

(1) banking companies including co-operative land development and land mortgage banks;

(2) financial corporations established under any Central, State or Provincial Act;

(3) the Life Insurance Corporation of India;

(4) Insurance companies and co-operative societies;

(5) the Unit Trust of India; and

(x) The duties and panalties prescribed in the Act for default to deduct and/or pay the tax deducted to the credit of the Central Government in furnishing a certificate, etc., in respect of salaries, dividends and interest on securities shall apply as well to the deduction of tax under the Section.

(xi) A return should be submitted by the person paying the interest of persons from whose income tax has not been deducted at source on the basis of an affidavit or attested declaration filed by them that the estimated assessable income will be less than the minimum liable to tax in the prescribed form verified in the prescribed manner. Such a return must be submitted in Form No. 27A within 30 days from the end of the 31st day of March each year. Persons making deduction of tax at source under this provision should also furnish quarterly statements in Form No 26A prescribed under Rule 37 (2A) giving details of the interest paid tax deducted. In the case of interest on deposits in joint names Circular No. 207 dated 24th April. 1980 has laid down the requirements in the matter of deduction of tax at source.

1. Where the income or Prize is less than Rs. 1,000	No tax need be deducted,
2. Income/Prize payable to	
(i) resident assesee	33.75%
(ii) company domestic	22.575%
(iii) other companies	73.5%
3. Where the prize is in cash or in kind	Calculate tax on cash & value of the prize,
4. Where the entire prize is in kind	No tax is to be deducted
5. Where the income prize is paid in instalments	Deduct tax at the time of payment of each instalment provided the total of all instalments exceeds Rs. 1,000.

Deduction of tax at source from winnings from lotteries and cross-word puzzle (Section 194B).

In cases where the recipient of the income from the lotteries or from cross-word puzzles is a non-corporate assessee, he would be entitled to apply to the Income-tax Officer and obtain from him a certificate authorising the payer to deduct tax at source at a lower rate or to deduct no tax, as may be appropriate in his case. Such a *certificate issued by the Income-tax Officer will* be valid for the period specified therein unless it is cancelled by the Income tax Officer earlier. For the purpose of deduction of tax at source, the lottery income will have to be rounded off to the nearest ten rupees and the tax to the nearest rupee. The tax deducted by the State Government should be paid or credited to the Central Government on the same.day by book adjustment; in all other cases, the tax must be paid to the credit of the Central Government within one month from the last day of the month in which the deduction was made. The person responsible for making the deduction is required to furnish the prescribed returns and to issue a certificate in the prescribed form. No decuction is, however, required to be made from other items of casual income which are specified in Section 2 (24) (ix).

Deduction of tax at source from income by way of winnings from horse races : Section 194BB provides for deduction of tax at source from income by way of winnings from horse race at such rates as may be prescribed in the annual Finance Act of the relevant financial year. Under the new provision the obligation to deduct tax at source would apply only in those cases where such winnings are paid by a book-maker or a person to whom a licence has been granted by the government under any law for the time being in force for horse racing in any race course or arranging for wagering or betting in any race course. However, no tax is required to be deducted at source where the income by way of winnings from horse races to be paid to any person is Rs. 2,500 or less;

In this context, the expression '*winning from horse race*' has to be taken to mean the amount · received by the punter in excess of the bet laid by him on the horse or horses which has/have won in the particular race. Whenever a punter places bets on more race horse than one in any particular race the expression '*winning*' should be taken to mean the amount won by the punter in that race as reduced by the amount invested by way of bet on the particular horse or horses which won the race and not by amount invested on the horse or horses which had lost in the race. For instance, in a case where a punter invests Rs. 1,000 each on two horses A and B and in a particular horse race he wins, Rs. 5,000 on the bet placed on horse A but loses the bet on horse B, the winnings of the punter from his horse race should be taken at Rs. 4,000 i.e., Rs. 5,000—Rs. 1,000) and not Rs. 3,000 i.e. Rs. 5,000—2,000.

*** Relevant circular 257/4.6.79 and 241/1.6.78**

Wherever the income by way of winnings from horse race payable to any person exceeds Rs. 2,500, the tax will have to be deducted at source from such winnings even though the winnings may be paid to the person concerned in instalments of less than Rs. 2,500. Similarly in cases where the book-maker or other person responsible for paying the winnings for horse credits such winnings and debits the losses to the individual account of the punter, the set off the loss against the income would be treated for this purpose as a constructive payment of the income. Therefore, wherever the income by the way of winning from a race horse credited to the individual account of the punter exceed Rs. 2,500, tax will have to be deducted at source at the time of payment of such winning even though the net amount payable to punter after adjustment of losses debited in his individual account may be less than Rs. 2,500.

In the context of the provisions of Section 194 BB, the expression '*any race horse*' used therein must be taken to include, wherever the circumstances so necessitate, more than one race horse. Therefore, winnings by way of jack pot would also fall within the scope of Section 194BB. However, there will be no question of deduction of tax at source on the income by way of a stake money particularly because the stake money does not rise by virtue of betting on the race horse. It has been clarified by the explanatory note issued by the Central Board of Direct Taxes that '*stake money*', in common parlance, is not regarded as winning from a race horse but it really constitutes the 'prize money' received on the race horse by the owner thereof on account of the fact the horse wins the race or stands second or in any lower position.

Deduction of tax at source from winnings from horse races is required to be made at the rate of 33.75 per cent (comprising of 30 per cent by way of income-tax and 3.75 per cent by the way of surcharge thereon). In the case of all non-resident non corporate tax-payers, the tax will have to be deducted at source on the same basis as is currently applicable to income other than interest payable on a tax free as Government security i.e. at the rate of 33.75 per cent or the appropriate rate of income-tax applicable to the winnings from horse race if amount of such winnings were the total income of the assessee concerned, whichever is higher. Refer also to Circular No. 276 dated 19th July, 1980.

Deduction of tax at source from payments to contractors and sub-contractors (Section 194C). Section 194C provides for deduction of income-tax at source from the payment made to contractors and sub contractors in certain cases. Any person responsible for paying any sum to a resident contractor for carrying out any work or supplying labour for carrying out any work in pursuance of a contract with the Central Government, a State Government, local authority, statutory corporation or a company must deduct income tax at the rate of 2% from any such sum paid. Similarly a contractor, not being an individual or a Hindu undivided family, will in

certain cases, be required to deduct tax at the rate of 1% from any payment made by him to resident sub-contractor after that date. The substance of the provisions is explained hereunder :

(i) In the case of contractors, deduction of Income-tax will be made only where the payment is made by the Central Government, a State Government or a local authority or a corporation established by or under a Central, State or Provincial Act or by a company (such authority, corporation or company being hereinafter referred to as the "specified person.") and the contractor is a person resident in India. The deduction of income-tax at source from payments made to non-resident contractors will continue to be governed by the provisions in Section in 195 of the Income-tax Act, 1961.

(ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to 'works contracts' and 'labour contracts' and will not cover contracts for sale of goods.

1. Contracts for the construction building or dams or laying of roads and air fields eg or railway lines.
2. Contracts entered into for processing of goods supplied by the Government. Contracts of fabrication of sea and river crafts where meterials are supplied by the Government and ownership of such goods or materials remain throughout with the Government.

(iii) Contracts for rendering professional services by lawyers physicians, surgeons, engineers, accountants, architects consultants etc., can also not be regarded as contracts for carrying out any "work" and, accordingly, no deduction of income tax is to be made from payments relating to such contracts.

(iv) The deduction of income-tax must be made at the time of credit of the sum to the account of the contractor, or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(v) The question whether a deduction under this provision will be made with reference to the gross payment due to the contractor or the net payment *i.e.*, gross payment minus deductions if any, on account of materials supplied by the Government or other specified persons will have to be decided in the light of the terms of the particular contract and the conduct of the parties thereto. Where the contractor has undertaken to construct a building or a dam, and the Government or other specified person has undertaken to supply all or any of the materials necessary for the work at stipulated prices, the deduction will have to be related to the gross payment without excluding any adjustments on account of the cost of materials. Where however, the contractor has undertaken only to provide the labour for the work, the ownership of the materials supplied remaining at all time with the Government or other specified person, the sum payable to the contractor in respect of the contract

will only be the amount paid for such labour or services and will thus not include the price of the materials supplied by the Government or other specified person.

(vi) The rate of deduction of income-tax from payment made by the Government or other specified persons to any contractor will be 2% of the gross payment or, as the case may be, the net payment, depending on the terms of the contract, as explained in item (v) above.

(vii) No deduction will be required to be made if the consideration for the contract does not exceed Rs. 10,000.

(vii) Where a contractor, not being an individual or a Hindu undivided family engaged for carrying out any work or for supplying for labour carrying out such work by the Central Government or a State Government, a local authority, a corporation established under a Central, State or Provincial Act or a company has, in turn, engaged any sub-contractor (a) for carrying out the whole or any part of the work undertaken by the contractor, or (b) for the supply of labour to carry out such work, or (c) supplying any labour which the contractor had undertaken to supply, he will be required to deduct income-tax at source from the payment made to the sub-contractor at the rate of 1% of such payment. The provisions governing payments to contractors as set forth at items (iv), (v) and (vii) will apply mutatis mutandis to payments made by contractor to sub-contractors.

(ix) It is open to the contractor or the sub-contractor, as the case may be, to make an application to the Income-tax Officer concerned and obtain from him a certificate authorising the payer to deduct tax at such lower rate or deduct no tax as may be appropriate to his case, such a certificate will be valid for the period specified therein unless it is cancelled by the Income-tax Officer earlier.

(x) The amount of tax to be deducted at source should be rounded off to nearest rupee.

(xi) The tax deducted on behalf of the Government should be paid to the credit of the Central Government on the same day by book adjustment. In other cases, the tax deducted should be paid to the credit of the Central Government within one week from the last day of the month in which the deduction is made.

(xii) The persons responsible for making any payment to contractor, or sub-contractor, as the case may be, should issue a certificate showing therein particulars of the payment, the amount of tax deducted at source and the date of credit, etc.

The return of tax deducted at source from payments to contractors should be furnished in Form 26C prescribed under Rule 37 (2C) quarterly to the I.T.O. on 15th October, 15th January and 15th April in respect of the deduction made in the immediately preceding quarter.

Deduction of tax at source from insurance commission (Section 194D): Section 194D provides that any person responsible for paying to a resident any income by

way of insurance commission or other remuneration in consideration of his soliciting or procuring insurance business (including the business relating to the continuance, renewal or revival of policies of insurance) is required to deduct income-tax from such income at the rates prescribed in part II of the First Schedule to the Finance Act for the relevant year. The deduction is to be made at the time of the credit of the income to account of, or the payment thereof (by whatever mode to the payee, whichever is earlier).

In some cases a portion of the premium paid may be refunded to the insurer. At the time of making the refund of premiums, the agent's account is debited by an appropriate amount representing the commission on the premiums refunded, at the time of subsequent credit, an adjustment of the earlier debits should not be made and tax at the prescribed rate should be deducted from the *full amonnt* of the subsequent credit. [*Circular No. 277 dated 21st July 1980 issued by the C.B.D.T.*]

The payment of insurance commission should be accompanied by a certificate of deduction in Form No. 19D. If the assessee wants a reduction in the rate of tax for purpose of Section 194D or no deduction he should apply to the Income-tax Officer for a certificate in Form No. 13 D. Any person deducting tax at source under this Section should send to the I.T.O. having jurisdiction to assess him quarterly and yearly return in respect of tax deducted and annual return in respect of insurance commission credited.

According to Rule 37 (2D) the certificate of tax deduction at source from insurance commission should be furnished in Form No. 26D to the I.T.O. quarterly on 15th July, 15th October, 15th January and 15th April in respect of deduction of tax made in the immediately preceeding quarter; the annual statement should be filed in Form No. 26E on or before 30th June every year. The statement of insurance commission paid or credited without deduction of tax at source in each financial year should be filed annually on or before 30th June of every year. [Refer also to circular No. 278 dated 15.4.1978 in 117 I.T.R. (St.) 13].

Other sums: Under Section 195 all sums chargeable to income-tax (other than interest on securities or dividends) shall be subject to deduction of tax at source at the rates prescribed by the relevant Finance Act. In order to subject an item of income to deduction of tax under this Section all the following conditions must be fulfilled :

(a) The payee, if he is a person other than a company, must be a non-resident within the meaning of Section 6(6).

(b) If the payee is a company, the company must be (i) non Indian and (ii) one which has not made prescribed arrangement for the declaration and payment of dividends within India.

(c) The amount payable should be income representing interest or any other

sum : but it should not be an income representing interest on securities or dividends.

(d) The person responsible for making the payment should not himself be liable to pay tax thereon as an agent or representative assessee.

(e) The payment should be one which is not made in the ordinary course of the business between a resident broker who makes the payment and a non-resident broker who receives it.

The Section would apply even in cases where money is paid into a Court under a decree obtained by a non-resident. Also, a person who is responsible for making payment to a non-resident and who, on the instruction of the non-resident, makes the payment to his resident agent in India is nevertheless liable to deduct tax at source. In cases where the interest or other items of income payable abroad is chargeable to tax in India, failure to deduct the tax under this Section may disentitle the payer to any deduction in respect of such interest or other payment under Sections 21, 25, 40, (a) (i) and 58 (1) (ii). The deduction contemplated by this Section is to be made at the time of actual payment and not merely when the interest credited to the creditor's account in the books of the borrower when it is capitalised. But when the capitalised interest is paid off with the principal capital sum, then, at the time of payment, that part of the amount paid representing interest capitalised, must be subjected to deduction of tax.

The statutory obligation imposed under Section 195 of the Income-tax Act would apply for the purpose of deduction of tax at source from any sum being income assessable to tax (other than interest on securities, salary and dividends, payable to any non-resident person). The requirement for deduction of tax at source would not apply only in those cases where the assessee himself is liable to pay the tax on the non-resident's income in his capacity as an agent of the non-resident. Payment to a non-resident by way of royalties and payments for technical services rendered in India are common examples of sums chargeable under the provisions of the Income-tax Act to which the liability for deduction of tax at source would apply.

In cases where the amount payable to a non-resident is stipulated to be paid to him net of taxes *i.e.* (where the tax payable by the non-resident is borne by the person who makes the payment, the income chargeable to tax in the hands of the resident must be determined by grossing up the net of tax payment to such an amount as would after deducting tax of such a gross amount leave the stipulated amount of net income which is paid or payable to the non-resident. Accordingly, the income chargeable to tax in the hands of the non-resident recipient must be grossed up and it is with reference to this grossed up amount that tax will have to be deducted under Section 195. No deduction is to be made in respect of tax ...

this Section from payments which in reality are mere trading receipts and do not constitute income chargeable to tax under the Act. Thus, when the price for goods supplied is paid to a non-resident seller, no deduction of tax has to be made under this Section although upon making up the accounts at the end of the year it may be found that an element of profit was contained in the receipt of the sale price.

The tax so calculated and deducted must be paid to the credit of the Central Government as required by Section 200 of the Income-tax Act read with Rule 30 of the Income-tax Rules and should not be withheld on the ground that the tax would, in any case, be paid by the person making the payment ultimately when regular assessments are made in respect of the income of the non-resident payee. Any failure to deduct tax at source or to pay the tax as required by Section 195 would render the person liable to penalty under Section 201 read with Section 221 of the income-tax Act. In addition, he would also be liable under the Section 201 (IA) to pay simple interest at 12% per annum on the amount of such tax from the date on which the tax sought to be deducted to the date on which the amount is actually paid. Still further, the failure to comply with the provisions for deduction of tax at source would also attract liability for prosecution under Section 276B.

Deduction of tax has to be made at the prescribed rates (unless a certificate is obtained from the I.T.O. under Section 197) irrespective of the fact that the non-resident may turn out to be not assessable at all when the assessment is ultimately made upon him or that the non-resident is entitled to a deduction of the income from his gross total income under the Act.

However, where a person responsible for paying any such sum chargeable under this Act (other than interest on securities, dividends and salaries) to a non-resident considers that the whole of such income would not be taxable in the hands of the recipient, he may make an application to the I.T.O. concerned in writing to determine, by a general or special order, the appropriate portion of such income so chargeabla and upon such determination by the I.T.O. tax shall be deducted only on that portion of the sum which is so chargeable to tax in India.

With a view to removing avoidable hardship and inconvenience to concerns who, though technically not resident in India, conduct their activities in this country on a more permanent basis through a branch or other establishment and are regularly assessed to income-tax in India and to do away with the requirement of deduction of tax at source with reference to the income element embodied in the payment made by a large number of consumers for goods or services provided by non-resident concerns in India, the law provides that any non resident tax payer (including a foreign

I.T.O. for a certificate authorising him to receive payments by way of interest (other than interest on securities) or any other sum (not being dividends) without deduction of tax at source. Such an application may be made in the cases and under the circumstances specified by Central Board of Direct Taxes under the Income tax Rules. On receipt of such an application the I.T.O. may, subject to such conditions as are laid down in the Rules give a certificate authorising the payment of the income without deduction of tax at source. Every person responsible for paying any such interest or other sum to the holder of the said certificate shall make such payment without deduction of tax at source so long as the certificate is in force *i.e.*, the period specified in the certificate for if is it cancelled by the I.T.O. earlier, till the date of its cancellation.

According to the Proviso, to sub-section (1) of Section 195 income by way of capital gains from the transfer to any long term capital asset would also be subject to deduction of tax at source under this Section in cases where such capital gains arising are paid or payable to a foreign company. The tax to be deducted at source should be calculated in accordance with the provision of (Section 115 (1). The expression "foreign company" for this purpose means a company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration and payment of dividends within India.

The expression "*payment*" which is taken as the basis for imposing the statutory obligation to deduct tax at source should be interpreted as amounting to actual payment of money which constitute income chargeable to tax in India by the person in India to a non-resident. The crediting of interest or other amounts to the account of the creditor would not be deemed to be a "payment" and, therefore, no deduction would be required to be made when the income due to the non-resident is merely credited to his account in India. In cases where the income is merely capitalised and there is no actual payment, no deduction of tax at source would be required to be made; if, however, the capitalised amount is subsequently paid along with the principal or any other sum the amount that is snbsequently paid must be subjected to deduction of tax at source. Even in cases where the income payable to the non resident is actually paid to the agent of the non-resident in India as per his instructions. the person paying the income must deduct tax at source although the payment is made to a person within India who may be resident. This is because of the fact that the Indian agent receives the income only for and on behalf of the non resident and the payment to the Indian agent in law constitutes a payment to the non-resident although such payment may not be made to any one outside the country immediately. Similarly if the payment is made to a court under a decree or under other specific orders or to a third person in satisfaction of that persons' decree the liability to deduct tax at source still continues and the person liable to pay the income, must therefore, deduct tax at source to the extent of the tax payable

on the income. A person who is liable to pay tax by way of deduction at source under this section is not, however, bound to *be made liable for the ultimate assess*ment that night be made on the non-resident in respect of his income chargeable to tax in India. The liability to deduct tax at source and also the order of the Income-tax Officer calling upon the person to deduct tax and pay tthe same to the Government or to treat the assessee as in default are not barred by limitation and. therefore, the time limits for completion of assessment or re-assessment or for rectification of mistakes would nor apply ta cases whese the assessee has to discharge his statutoty obligation to deduct tax at source.

Rule 29B of the income-tax Rule deals with the application for certificate authorising the receipt of Interest and other sums without deduction of tax at source. Accordingly any person entitled to receive any interest or other sum on which income-tax has to be deducted under Section 195 (1), may make an application for the grant of a certificate under Section 195 (3) authorising him to receive without deduction of any tax such income as is specified below :—

(i) Where the person concerned is a banking company which is neither an Indian company nor a company which has made the prescribed arrangements for the declaration and payment of dividends within India, and which carries on operations in India through a branch, any Income by way of interest (other than interest on securities) or any other sum (not being dividends);

(ii) In the case of any other person who carries on a business or profession in India through a branch, any sum not being interest or dividends, insofar as such interest or other sum is receivable by such branch on its own account and not on behalf of its head office or any branch situated outside India or any other person.

The conditions to be fulfilled by the person who makes an application for a certificate to receive such interest or other sum without deduction of tax at source are :

(a) The person concerned should have been regularly assessed to income-tax in India and must have furnished the returns of income for all assessment years for which returns become due on or before the date on which the application is made.

(b) He should not be in default or be deemed to be in default in respect of any tax (including advance tax) and tax payable on self assessment interest, panalty, fine or any other sum payable under the Act.

(c) He should not have been subjected to penalty under Section 271 (1) (c) (iii) for concealment of particulars of income for furnishing inaccurate particulars of such income.

(d) Where the person concerned is not a banking company referred to above—

(i) he should have been carrying on business or profession in India continuously for a period of not less than five years immediately preceding the date of application, and

(ii) the value of the fixed assets in India of such business or profession as shown in his books for the previous year ended immediately before the date of the application or where the accounts in respect of such previous year have not been made up before the said date the previous year immediately preceding that year exceeds Rs. 50 lakhs.

The application by a banking company must be in Form No. 15 and where the applicant is any other person it should be Form 15D. The Income-tax Officer may give a certificate in Form No. 15E authorising the person concerned to receive the income without deduction of tax at source, if he is satisfied that all the conditions stated above are fulfilled and then the issue of any such certificate will not be prejudicial to the interests of the revenue. The certificate shall be valid for the financial year specified therein unless it is cancelled by the Income-tax Officeer at any time before the expiry of the said financial year. An application for a fresh certificate may be made, if required, after the expiry of the period of validity of the earlier certificate or within three months before the expiry thereof.

Tax not to be deductcd in certain cases (Section 196): No deduction however, shall be made by any person out of any amount by way of interest on securities, dividends, interest other than interest on securities or other sums payable to—(i) the Central Government; (ii) the Reserve Bank of India; (iii) a corporation established by or under a Central Act which is under any law, for the time being in force, exempt from income-tax on its income. The exemption is available in respect of sums payable to it by way of interest or dividend in respect of any securities or shares owned by or in which it has full beneficial interest or any other income accuring or arising to it.

Section 197A. Inserted with effect from 1-6-1982, sec. 197A enables an *individual who is resident* in India and whose estimated total income of the previous year is less than the minimum liable to income-tax to receive interest on securities, dividends and other interest without deduction of tax at sonrce under sections 193, 194 and 194A on furnishing a declaration in duplicate; in the prescribed form and verified

the prescribed manner. The relevant rule is 29C and Forms are 15F, 15G and 15H.

The declaration in the above form is to be furnished by the declarant to the person responsible for paying any income of the nature referred to in section 193 or 194 or 194A. The declaration will have to be to the effect that the estimated total income of the declarant of the previous year including such interest on securities, dividend or other interest will be less than the minimum liable to income-tax. On receipt of this declaration, the person responsible for making the payment will be required to deliver or cause to be delivered to the commissioner of income-tax who exercises the jurisdiction over him, one copy of the declaration on or before the 7th day of the month following the month in which the declaration is furnished.

It may be noted that section 197A of the I.T. Act has got the effect of superseding the provisions of sections 193, 194 and 194A of the Act *only in so far as these cast a legal obligation on the person responsible for* paying the income- of the nature referred to in the said sections to deduct tax at source. Thus the provisions of sections 193, 194 and 194A which provide a facility for receiving the income referred to therein without deduction of tax at source, under the circumstances and subject to the fulfilment of the conditions specified therein, continue to be in force and the facility provided in new section 197A is in addition to the facility provided under the existing provisions in sections 193, 194 and 194A of the I.T. Act.

Another point to be noted here is that where payments are to be made by the same person more than once in a year, the declaration in the relevant form may be furnished before the first payment in a year becomes due. It may also be noted that in the declaration form particulars of only such securities, shares or other deposits are to be furnished the income from which is payable by the person to whom the declaration is furnished.

Credit for tax deducted at source (Section 199) : Tax deducted at source is a sort of payment of tax in advance to be adjusted at the time of assessment against the tax due. Where the income of another person is included in the assessee's total income under Section 60 to 64 or 92 to 94, the tax in respect of such income deemed to have been paid on behalf of the assessee and credit must be given to him (and not to the other person) in respect thereof. Where any share or security is jointly owned by two or more persons not constituting a partnership credit in respect of the tax deducted should be given to each such person in the same proportion in which they share the income from interest or dividends. It is specifically provided that a credit for the amount of tax deducted at source shall be allowed to the assessee in the provisional assessment for refund itself instead of in the final assessment.

Further, the Central Board of Direct Taxes is empowered to prescribe in the Income-tax Rules the circumstances in which credit for the tax deducted at source from dividend on shares may be granted to a person other than a registered shareholder where such a dividend is assessable as the income of the other person. Accordingly, under Rule 30A of the Income-tax Rules where the dividend on any deduction of tax made under Section 194 and paid to thc Central Government, shall be deemed to be a payment of tax on behalf of, and credit in respect of the same shall be given to, the other person. The circumstances in which such credit can be claimed are thc following :

(i) Where a company has a right to appoint any person or persons, or where any nominee (s) of the company has (or have) been appoimted as a director or directors of an other body corporate and shares owned by such company in such other other body corporate, of an amount not exceeding the normal value of the shares which are required to be held by a director thereof are registered in the name of any such person nominee ;

(ii) Where a company owns any shares in its subsidiary and such shares are registered in the name or names of any nominee or nominees of the company, if and in so far as it is necessary so to do, to ensure the number of members of the subsidiary is nol reduced, where it is a public company, below seven and where it is a private company, below two ;

(iii) Where a corporation established by or under a Centre, State or Provincial Act owns any shares in a company and such shares are registered in the name or names of any nominee or nominees of the corporation in the circumstances specified in clause (i) or clause (ii) above ;

(iv) Where any person deposits with any bank, including a co-operative bank or a land inortgage bank, any share owned by him, for the collection of dividends thereon and such shares are registered in the name of the bank ;

(v) Where any person deposits with any other person any shares owned by him, by way of security for the repayment of any loan or the performance of any obligation and such shares are held by, or on behalf of, any of the following namely :—

(a) the Government or the Reserve Bank of India or any body corporate owned by the Government, or the Reserve Bank of India, or in which not less than forty per cent of the shares are held (whether singly or taken together) by the Government or the Reserve Bank of India or a corporation owned by that bank ; (b) a local authority ; (c) the State Bank of India or any of its subsidiary banks ; (d) any banking company including a co-operative bank or a land mortgage bank ; (e) the Industrial Finance Corporation of India, the Industrial Credit and Investment Corporation of India Ltd, the Madras Industrial Credit and

Investment Corporation of India Ltd., and the Refinance Corporation for Industry Ltd.; (f) a State Financial Corporation established under the State Financial Corporation Act 1951; (g) an Industrial Development Corporation established in India by a State Government; (h) the life Insurance Corporation of India; (i) the Industrial Development Bank of India;

(vi) Where the shares are held by a *trustee appointed under a trust declared by a duly executed instrument in, writing whether testamentary or otherwise including any wakf deed which is valid under the Mussalman Wakf Validating Act 1913 and the dividend thereon is received by the trustee on behalf of, for the benefit of any person who is beneficiary of the trust ;*

(vii) Where the shares owned by a firm are held in the name of any of its partner ;

(viii) Where the shares owned by a Hindu undivided family are held in the name of the Karta or any other adult member of the family ;

(ix) Where the shares have been sold or otherwise transferred by the registered shareholder and action for registering the transfer in the name of the purchaser or other person has been taken in accordance with thc provision of Section 108 of the Companies Act, 1956 ;

(x) Where the share owned by member of a recognised Stock Exchange in India deposited with the Stock exchange in accordance with the regulation of the exchange are registered in the name of the trustees of the Exchange or the bankers of the Exchange'

The beneficial owner of the shares is entitled to claim this benefit only if he furnishes a declaration to the I.T.O. in form No. 15B signed by himself and the registered shareholders together with the certificate for tax deducted at source in Form No. 19.

Person reponsible for paying taxes deducted at source. (Section 204) : For purposes of deduction of tax at source the expression "person reponsible for paying" means—

(i) In the case of income from "Salaries" (other than payment of salaries by the Central or State Government) the employer himself ; or if the employer is a company, the company itself including the principal officer thereof.

(ii) in the case of income from interest on securties (other than payments by or on behalf of the Central or State Government) the local authority, corporation including the principal officer thereof.

(iii) In the case of any other item of credit or income in respact of which tax is to be deducted at source—the payer himself or if the payer is a com-

pany the company itself inclucing the principal officer thereof.

In all cases where tax has been deducted at source from salaries every employer shall prepare, within thirty days from the end of each financial year, and deliver to the I.T.O.in the prescribed from and verified in the prescriabod manner a return in writing giving details of (a) the name, occupation and address of, person to whom he had paid salaries during the previous year, (b) the amount of salaries inclusive of perquisites whether paid or due, (c) the amount of tax deducted at source, (d) the dates of deduction, and (e) such other particular as may be prescribed.

Every person reponsible for deducting tax under any of the Sections 192 to 195 shall at the time of the credit or payment of the sum or, as the case may be, at the time of issue of a cheque or warrant for payment of any dividends to a shareholder furnish a certificate to the effect that tax has been deducted and specify the amount so deducted, the rate of deduction and such other particulars as may be prescribed (Section 230 and Rules 31).

Further, under Section 206A, persons paying interest to residents without deduction of tax at source are required to furnish a return within thirty days from the end of each financial year to I,T.O. in prescribed form and verified in the prescribed manner showing details of ;

(a) the name and address of every person who has furnished to him an affidavit or statement for getting the income without deduction of tax ;

(b) the amount of income paid or credited to each such person during the financial year, and the number of times at which the same was paid or credited ; and

(c) such other particulars as may be prescribed. (Rule 37A).

Similarly, the persons responsible for deduction of tax at source from dividends payable by companies are also required under Section 206B to furnish an annual return in respect of dividends paid without deduction of tax at source in Form No. 27B (Rule 37B). The particulars to be furnished in the return and the time for submission of the return are similar to those mentioned in the preceding paragraph.

Other provisions :—Under Section 198 the tax deducted at source is deemed to be the income of the assessee for all purposes of computation of income and assessment. The person responsible for deducting the tax at source is obliged to deposit the sum of tax deducted immediately to the credit of the Central Government (Section 200).

Rule 30 of the Income-tax Rules provides that all sums of tax deducted under Section 192 to 195 shall be paid to the credit of the Central Government within the following time-limits :—

(i) In the case of deduction by or on behalf of the Central Government—on the same day.

(ii) In all other cases :

(a) In respect of sums deducted under Section 194A—

(1) where the income by way of interest is credited or paid by a person carrying on a business or profession to the account of the payee as on the date upon which the accounts of such business or profession are made within two months from the calendar month in which the date falls ;

(2) in any other case within one week from the last day of the calendar month in which the deduction was made ;

(b) in respect of sums deducted in accordance with the other provisions—within one week from the date of such deduction or the date of receipt of the challan by the person making the deduction, as the case may be.

However, the I.T.O. may, in special cases and with the previous approval of the Inspecting Assistant Commissioner, permit the person to pay the income-tax deducted quarterly on—

(i) 15th July, 15th October, 15th January and 15th April in the case of interest other than interest on securities ; and

(ii) 15th June, 15th September, 15th December, and 15th March, in the case of income from salaries.

The mode of payment in all cases has been specified in the Rule under sub-rules (2) and (3).

If the person responsible for paying fails to deduct, or having deducted, fails to deposit the amount within the specified time. he will be treated as an assessee in default and would de liable to pay the same with simple interest at 12% per annum for the period during which the default continues. He shall also be liable to the penalty, if any, which I.T.O. may impose under Section 276B if he is statisfied that the person had wilfully failed to deduct or pay the tax. Such interest or penalty shall also be charged on the assets of the defaulter (Section (231).

Deduction of tax at source is only one of the modes of recovery of tax. It does not debar the tax authorities from taking recourse to such other modes of recovery of taxes as they may deem fit (Section 202). However, where tax is deductible at source from certain types of income, the assessee shall not be called upon to pay the tax on such income directly to the extent to which tax has been deducted therefrom (Section 205).

(X) (III) Advance Payment of Tax : (Section 207 to 219).

Introduction : The Income-tax Act requires the payment of tax in advance of assessment during *any financial year* in equal instalments on specified dates on the tax payer's current income (other than capital gains or income by way of winnings from lotteries race winnings etc.) which is liabie to tax in respect of the assessment year next following the said financial year. The income on which advance tax is payable is called 'income subject to advance tax' and the tax so payable is balled "advance tax" (Section 207). The system of advance payment of tax is also known as the Pay as You Earn Scheme (PAYE). The purpose of introducing the scheme is to lighten the intensity of burden of taxes which would be felt by the assessee if the taxes were to be paid in lumpsum at one time and also to ensure a regular flow of revenue to the Government.

Threshold for payment of advance tax (Section 208) : Advance tax is payable only where the income of the assessee subject to advance tax exceeds the limit specified below :

(a) Rs. 2,500 in the case of a company or a local authority :

(b) Rs. 20,000 in the case of a registeted firm ;

(c) Rf. 12,000 in the case of H.U.F. having one or more members with independent total income exceeding the exemption limit ; and

(d) Rs. 15,000 in any other case, (including the case of a non-resident).

In cases where thc assessee is one who has not hitherto been assessed to tax then, the liability to pay advance tax arises in his case by virture of Section 212(3) under which he is required to make an estimate of his total income.

However, an agent or a representative assessee is not liable to make any advance payment of tax in respect of a non-resident's income merely because he was assessed as an agent in the past years or is likely to be assessed in the current year. The liability for the statutory agent arises in any year only if the I.T.O. has served a notice for advance payment of tax in respect of the year.

Computation of advance tax payable (Section 209) : The amount of advance tax payable will be calculated on the basis of the later of the two assessments stated below :

(a) **Total income assessed by way of regular assessment of the latest previous year.**

(b) **Total income of the latest previous year on which the assessee has paid tax on the basis of self-assessmet.**

If the assessee is a partner of a registered firm and the assessment of the firm has been completed for a previous year later than the latest previous year for

which the assessee's own assessmet has been completed, his share in the income of the firm on the basis of the assessment of the firm must be taken into account for the purposes of advance tax. But this rule does not, however, apply to income from unregistered firms.

The amount of advance tax payable by an assessee in any financial year should be arrived at as follow :

(i) His total income of the later of the two previous years, as the case may be, stated above shall first be ascertained.

(ii) The amount of capital gains and casual items of income specified in Section 2 (24) (ix) if any. included therein shall be deducted.

(iii) On the balance, income-tax payable by the assessee at the rates in force for the financial pear shall be calculated.

(iv) The income-tax so calculated shall be reduced by the amount in full of tax deductible at source in respect of salaries, interest, dividends, etc. under Sections 192 to 165 which are included in the income subject to advance tax.

The net amount of income-tax calculated as aforementioned shall be the amount of advance tax payable by the assessee in respect of the relevant financial year,

Sub-section (2) and (3) of Section 209 which were specially inserted in the Act provide that the net agricultural income of the assessee, whenever includible in the total income of the assessee for determining the rates of tax applicable to the non-agricultural income and for arriving at the amount of tax payable thereon, should be included in the income subject to advance tax. In view of this provision. all assessees hoving agricultural income should include their net agricultural income as per their latest regular assessment or as per their own self assessment under Section 140 A for the purpose of determining the amount of incomc subject to advance tax payable under Section 209. Similarly the Income-tax Officer is also required to take the net agricultural income of the assessee into account while issuing notice to the assessce for payment of advance tax under Section 210.

In case where the assessee is a H.U.F. having at least one member whose total income of the relevant previous year exceeds the maximum amount not chargeable to tax, the advance tax payable by the family as per its own estimate or as per the notice of demand issued by the Income-tax Officer should be calculated in accordance with the rates prescribed by the annual Finance Act for determining the tax payable by the assessee family. The computation of tax at these special rates in the case of a H.U.F, is however, subject to the provision of Section 164 under which tax has to be charged at the rate applicabie to the [illegible] if it were the income of an association of person or at the rate of

65% whichever is higher. Accordingly in cases where the provisions of Section 164 operate to impose tax at higher rates on the basis that share of the beneficiary in the income is inderterminate or unknown the computation of advance tax should be made on the basis of the provisions of Section 164 and not on the basis of Section 209(3).

Statutory obligation to pay advance tax : Tax payers who have already been assessed to income tax by way of regular assessment are also required to pay advance tax on the basis of their own estimate or statement *without waiting* for the receipt of a notice for payment of advance tax from the Income Tax Officer. In other words, there is no obligation on the part of Income-tax Officer to issue a notice requiring the assessee to pay specific amount of advance tax.

Section 209 A provides that every person, irrespective of the question whether he has already been assessed to Income-tax or not, should voluntarily make an estimate of income tax-payable by him in advance in every case where his current income for the relevant financial year is likely to exceed the amount specified in Section 208 (2) as being the limit beyond which he would attract liability to pay advance tax. Under this provision a tax payer who has previously been assessed by way of regular assessment under the Income-tax Act is required to submit a statement in Form No. 28 A of the advance tax payable him to the Income-tax Officer and indicate in the statement the amount of his current income as also the extent to which the current income is likely to exceed the limits specified in Section 208 (2). The income that forms the basis for the purpose of furnishing the statement is the total income of the latest previous year in respect of which he has been assessed by way of regular assessment or, if a retnrn of income has been filed by him for a subsequent previous year on the basis of which tax has been paid by him on self-assessment, then the total income which forms the basis of such self-assessment should be taken as the basis for determining the current income.

Sub-section (2) of Section 209A, however, provides that in cases where the taxpayer is one who is regularly assessed to income tax and he estimates that his current income of the previous year in respect of which he is required to furnish the statement of advance tax would be less than the total income as mentioned above, he would be entitled to exercise the option of furnishing the estimate of his current income under Section 212 instead of furnishing a statement of his current income under Section 209A(1). But a taxpayer who has not previously been assessed to income-tax by way of regular assessment should submit an estimate of his current income and the advance tax payable on or befor the date on which the last instalment of advance tax is payable in his case. The advance tax so computed on the basis of the estimate of statement should be paid by the assessee in equal instalment on the dates applicable to him under Section 211.

According to sub Section (3) of Section 209A in cases where an assessee has furnished statement of his current income under Section 239 (A) he would be entitled to exercise *the option of* filing an estimate of his current income under Section 212 if his current income is likely to be less than the income on the basis of which he is required to pay advance tax as per his statement. The estimate can be furnished by the assessee at any time before the last instalment of advance tax is due in his case.

Sub-section (4) or Section 209A is somewhat similar to Section 212 (3A) and the asseessee is required under this provision to furnish an estimate of the advance tax payable by him on the basis of his current income on or before the date on which the instalment of tax falls due in his case if the amount of advance tax payable on the basis of his current income exceeds the tax payable by him on the basis of the statement or the estimate furnished by him by more than 33-1/3 percent of the tax. In the case of companies, the permissible margin is 20%. They will be required to make an upward revision of the estimate of advance tax payable by them where the tax payable on their current income is likely to exceed the tax payable on the basis of the statement or estimate by more than 20%. The Commissioner of Income-tax is also empowered in appropriate cases, to extend the time limit for furnishing the estimate of advance tax in cases of this type upto a period of 30 days immediately following the accounting period in respect of the taxpayer's business or profession subject, however, to the condition that the assessee has paid the advance tax payable on the basis of the statement or estimate furnished by him before the date on which the last instalment is ordinarily due. The Commissioner would also be entitled to grant extension of time only in those cases where he is satisfied that having due regard to the nature of the assessee's business and accounting year followed by him, it would be difficult for him to furnish the estimate of the advance tax before the last date fixed for the purpose A taxpayer is entitled if he so desires, to send a revised estimate of the advance. tax payable by him at any time before the expiry of the dates of instalment for payments of advance tax and adjust any excess or deficiency in respect of the instalment already paid in the subsequent instalments.

All the provisions relating to instalmants of advance tax, interest payable by the assessee (including the interest payable in cases of under-estimate), penalty for non payment of tax, penalty for default in filing the estimate of advance tax, etc., would apply to taxpayers in relation to the obligation under Section 209A for payment of advance tax which has to be discharged even without waiting for the receipt of a notice of demand from the Income-tax Officer. Any failure on the part of the assessee to make payment of advance tax in accordance with the new provisions (as aforesaid) would make the assessee liable to be treated as an assessee in default and all the provisions for collection and recovery of tax under the law would become applicable. All the statement and estimates including an

estimate in lieu of statement furnished by the assessee for the purpose of payment of advance tax must be in the prescribed form and verified by the assessee in the prescribed manner. Althouge every assessee whose current income subject to advance tax exceeds the limit prescribed in Section 208 (2) is obliged to pay advance tax, the Income-tax Officer would still be empowered to issue a notice for payment of advance tax in any case under Section 210 of the Income-tax Act as at present. The power has been vested in the Income tax Officer to ensure that in cases where the assessee does not comply with the statutory obligation he can be compelled, by issuing a notice of demand, to pay the advance tax without waiting for the tax being recovered after the assessment is made.

Order by Income-tax Officer calling for the pament of advance tax (Section 210). Where a person has been previously assessed by way of regular assessment, the Income-tax Officer, on or at any time after the 1st day of April of the financial year, may pass an order requiring the assessee to pay the advance tax due from him and issue a notice of demand in form No. 28 under Section 156, specifying the amount, the number of instalment or instalments and the dates on which the advance tax is payable. The Income-tax Officer may amend the order at any time, which is not less than 15 days prior to the date of the last instalment for enhancing or reducing subsequently the instalment on the basis of the tax paid by the assessee wholly or partly on self-assessment or a subsequent regular assessment.

The I.T.O. is not bound to give a notice before passing an order under this Section. He is not also bound to pass such an order prior to the 15th of June of the financial year so as to afford an opportunity to the assessee to make advance payment of tax in three equal instalments. Thus even after one or more of the three prescribed dates of instalments have expired, he may order advance payment of a number of instalments corresponding to the remaining dates. An assessee must pay advance tax on such of those dates of instalments as are specified in the order of the I.T.O. even if he wishes to submit an estimate of his income subject to advance tax and the income estimated is less than that on which tax is demanded by the I.T.O. This obligation on the part of the assessee shall be enforceable only upto the date of filing the estimate. Also the notice of demand for advance tax would not be invalid merely because the amount mentioned in the notice is larger than that for which it should have been made. In the case of a company in liquidation, the Revenue is entitled to rank as a preferential creditor in respect of the advance tax demanded under this Section within twelve months prior to the date of the order of winding up.

The advance tax demanded by a notice under Section 210 by the I.T.O. must be paid by the assessee in accordance with the provisions of law. The fact that large amounts in respect of earlier years are refundable to the assessee

would not absolve the assessee of his liability to pay the advance tax demanded from him.

Instalments of advance tax (Section *211*) : The amount of advance tax shall be payable in three equal instalments on the following dates during any financial year, viz.

(a) 15th June, 15th September and 15th December in case of an assessee at least 75% of whose total income consists of income derived from any source in respect of which the previous year ends before the 31st of December of the relevant financial year.

(b) 15th September, 15th December and 15th March in any other case.

However, the Board has been authorised to allow the last instalment of advance tax, in the case of any class of assessee covered by (a) above, to be paid on the 15th March instead of on 15th December by notification in the Official Gazette specifying the conditions under which such an extension may be granted.

For this purpose, the expression '*total income*' means :—(i) in a case where advance tax is paid by the assessee on the basis of an order of the I.T.O. under Section 210, the total income with reference to which the amount of advance tax has been calculated in the order :

(i) In a case where the advance tax is paid in accordance with an estimate made by the assessee under Section 212, the total income with reference to which the advance tax is so estimated as reduced in either case, by the amount of capital gains and the casual items of income, if any, included therein.

The assessees can avail of only such of those instalments as are available to them and cannot claim to get these instalments as a matter of right.

Estimates by the assessees (Section 212) :

(*a*) *Where the assessee has previously been assessed* : An assessee on whom a notice of demand for payment of advance tax has been served by the I.T.O., is entitled to prepare and file an estimate of his income subject to advance tax in the current financial year by reason of the fact that it is likely to be less than the amount on which he is required to pay advance tax.

(*b*) *Where the assessee has not previously been assessed* : Any person who has not proviously been assessed to Income-tax by way of a regular assessment has the obligation to file an estimate of his current income including capital gains and casual income subjeet to advance tax if it is likely to exceed the limits specified under Section 208(2) as applicable to him.

A person cannot escape his liability to advance tax in respect of his share of income from an unregistered firm in which he is partner on the ground that it is only the firm and not he who has been assessed in respect thereof and that the

income from the firm is wholly exempt from tax in his hands since it is includible in his total income only for rate purposes. This is because of the fact that the firm is an assessable entity distinct and separate from the partners. For this purpose, the expression 'a person who has previously been assessed' means one in respect of whom the assessment proceedings for any earlier years have been completed and not the one in whose case the proceedings are still pending for any years' and not—necessarily the immediately preceding previous year.

(c) *Where the current income subject to advance tax is likely to be higher than the total income on the basis of which the I.T.O. has passed an order for payment of advance tax* : According to this provision it is obligatory for an assessee, to furnish an estimate of his current income subject to advance tax and pay the tax payable thereon in all cases where the advance tax payable on such current income is likely to exceed the advance tax demanded from him by 33-1/3% [20% in the case of companies] or more of the later. The duty to furnish such an estimate falls on the assessee irrespective of the fact whether the excess is due to the current income being higher than the total income last assessed on the basis of which advance tax was demanded by the I.T.O. or for any other reason. Any failure on the part of the assessee to furnish an estimate under the provisions will entail penalty under Section 278.

In all the above cases, the estimates shall be filed with the I.T.O. on or before the expiry of the date of the last instalment for payment of advance tax applicable to the assessee concerned. The estimate shall contain details of the current income and the advance tax payable thereon. The advance tax calculated on the basis of the estimate made by the assessee is to paid in one lump sum if only the date of the last instalment remains unexpired or in equal instalments in such number and dates of instalments as are available in his case. The estimate once made may be revised one or more times, at the opinion of the assessee, and no prior approval of the I.T.O. is needed for such a revision. The excess or deficiency in respect of the advance tax already paid may be adjusted by the assessee in his further instalments payable as per revised estimate. All estimates whether, original or revised, shall be made in Form No. 29 and shall be verified in the prescribed manner (Rule 39).

The proviso to Section 212 (3A) empowers the Commissioner to extend the time limit for furnishing the estimate of advance tax in the type of case specified in (c) above up to a period of 30 days immediately following the accounting period in respect of the tax payer's business provided that the tax payer has paid the advance tax demanded by the I.T.O. under Section 210 on or before the date on which the last instalment falls due in his case. Such an extension is permissible only in cases where the Commissioner is satisfied that having regard to the nature of the assessee's business and his accounting year, it will be

difficult for him to furnish the estimate of advance tax *before the last date fixed* for the purpose without any extension.

Commission Receipts (Section 213) : In cases where the *income* of an assessee subject to advance tax includes any income the nature of commission which is receivable by him periodically and the amount of such commission is not received or adjusted in assessee's accounts by the payer before any of the instalment of advance tax falls due, the assessee is entitled to defer payment of advance tax on such commission till the date on which it would normally be received or adjusted. But if the assessee does so, he must inform the I.T.O. the date upto which the payment is deferred.

Thus there may arise a case where the advance tax relating to financial year may have to be paid after the close of the year on account of a deferment made by the assessee under this Section. In such eases the advance tax, due on the commission so deferred, shall be paid within 15 days of its receipt or adjustment. After the 15th day payment is to be made together with simple interest @ 12% per annum on the tax so deferred from the date of the receipt or adjustment to the date of payment of the advance tax.

Interest payable by Government (Section 214) : The Government shall pay simple interest at the rate of 12% per annum from the 1st day of April of the relevant assessment year to the date of regular assessment in the following cases :

(a) When the amount of advance tax paid exceeds the amount of tax that is determined as payable on regular assessment—In the case of advance tax deferred and paid after the close of the financial year under Section 213 if it is found on regular assessment that the total amount of advance tax paid is in excess of the tax payable on regular assessment, the excess will be refunded with interest to the assessee. The amount of interest shall be calculated for the period from the date of payment of the deferred tax to the date of regular assessment.

(b) When the refund is not granted within three months from the date on which the total income liable to tax is determined (where the income does not solely consist of interest on securities or dividends) or within six months in other case from the date on which the claim for refund is made.

Where, however, a provisional assessment for refund has been made and the assessee has obtained refund under Section 141A no interest shall be payable subsequent to the date of the provisional assessment for refund. Further, where the amount on which interest had been paid is reduced on regular assessment, excess interest paid shall be recovered from the assessee. The other provisions relating to refunds including the refund of interest payable by the Government are discussed later on in this Study Paper under the head 'Refund'. The interest

received by the assessee under this Section is taxable as his income under Section 56 in every case.

Interest payable by assessee: (*A*) *General* (Section 215): Where the advance tax paid by the assessee on the basis of his own estimate is less than 75% (83⅓% in the case of companies) of the tax determined on regular assessment, he shall be liable to pay interest @ 12% *p.a.* from 1st April of the relevant assessment year to the date of regular assessment (but not re-assessment) on the amount by which the advance tax paid by him falls short of the assessed tax. For this purpose, the tax determined on regular assessment is to be reduced by the full amount of tax deductible at source. While calculating the shortfall in the tax paid, due regard shall be had to the increase in the tax due to changes in the rates of tax made by the subsquent Finance Act and the income which is not subject to advance tax.

For purposes of advance tax and penalty for non-compliance with the provisions relating thereto, the expression '*assessed tax*' means the tax determined on regular assessment (as reduced by the full amount of tax deductible at source) so far as such tax relates to income subject to advance tax and so far as it is not due to any variations in the rates of tax made by the Finance Act applicable to the year of regular assessment.

Where the assessee voluntarily pays the tax on self-assessment or otherwise before the completion of the regular assessment, the interest payable shall first be calculated as aforementioned upto the date of voluntary payment of tax, and thereafter, the interest shall be calculated on the amount by which the tax paid falls short of the assessed tax. Where the amount of tax is subsequently reduced on appeal or rectification of mistake, the interest paid shall also be refunded accordingly and the excess, if any refunded to the assessee.

(*B*) *Penal interest payable in cases of under-estimate, etc.* (*Section 216*):

(i) On making a regular assessment, if it is found by the I.T.O. that the assessee had reduced the amount of advance tax payable in the first two instalments by furnishing an under-estimate of his income under any of the circumstance covered by Section 212, he may direct that the assessee shall pay interest @ 12% *p.a.* on the difference between the amount actually paid in each such instalment and the amount that should have been paid for the peroid during which the payment was deficient. In doing so due regard shall be had by the I.T.O. to the aggregate amount of advance tax paid by the assessee during the year.

(ii) Similarly, where an assessee had unjustifiably deferred the payment of advance tax under Section 213 on commission receipts forming part of his income-the I.T.O. may impose penal interest on the amount of difference between the advance tax actually paid by the assessee and the tax that should have been paid for

the period during which the payment was so deferred. For this purpose, any instalment due before the expiry of six months from the beginning of the financial year in respect of which the instalment is payable shall be deemed to have fallen due fifteen days after the expiry of the said six months.

(C) *Penal interest payable where no estimate is made (Section 217)*

(i) Where a person who has not previously been assessed and is liable to furnish an estimate of his current income for advance tax purposes, in accordance with Section 212 (3) has failed to furnish the estimate, he becomes liable to pay interest at 12% *p.a.* on an amount equal to the difference between the advance tax paid and the tax assessed on regular assessment as reduced by the tax deductible at source from the 1st April of the assessment year to the date of regular assessment.

(ii) Sub-section (IA) provides that the penal interest at 12% shall be payable by an assessee whose current income is likely to exceed the income on which the advance tax demand was made by the I.T.O. by more than 33⅓% (20% in the case of companies) but who had failed to furnish the estimate as required by Section 222 (3A). Such interest will be chargeable on regular assessment for the period commencing from the 1st April of the assessment year to the date of regular assessment on the amount of shortfall between the tax paid by him and the tax determined on regular assessment.

Thus the penal interest under Section 216 is chargeable irrespective of the demand on regular assessment. The correctness of the payment of advance tax is to be judged on the basis of the estimate made and advance tax paid by the assessee and not only on the basis of the amount of tax determined on regular assessment. The distinction between the interest payable by the assessee under Section 215 and that under Section 216 is that the former is obligatory and, therefore, the I.T.O. is not authorised to waive the interest except in specified circumstance whereas, in the latter case, the I.T.O. is entitled to use his discretion in directing payment of the interest and consequently no provision has been made for its waiver. Further, the orders for charging interest under Section 215 are not specifically appealable while those under Section 216 are specifically appealable under Section 246 (m). The order under Section 215 could however, be revised by the Commissioner under Section 263. The Commissioner has also been empowered to reduce or waive the interest payable by the assessee under Sections 215 to 217 under the new Section 273 A.

The interest paid or payable by the assessee for shortfall in payment of advance tax is not allowable as a deduction in computing the taxable income of the assessee regardless of the head of income to which the income subject to advance tax relates. The successor karta of a H.U.F. is liable to pay the interest for the shortfall in the payment of advance tax made by the predecessor-karta, since deceased, who has made the estimate at a low figure.

The interest payable by the assessee does not have the same character as income tax payable although the interest levied on an assessee could be recovered in the same way as recovery of tax. For the purpose of charging interest for any default or shortfall in payment or proper advance tax, a separate order of the I.T.O. for the levy of interest is not necessary ; the order for levy of interest could be incorporated in the assessment order itself. The levy of interest can be done even in case where the I.T.O. makes a reassessment of the escaped income of the assessee. The procedure for calculation of interest has been laid down in Rule 119 A.

Waiver of interest. The Income-tax Officer has been authorised under Sections 215 (4) and 217 (2) to reduce or waive the amount of penal interest ordinarily leviable for an under estimate or failure to file an estimate in the following cases specified in Rule 40 of the Income-tax Rules 1962.

(i) Where the regular assessment is completed more than one year after the submission of the return and the delay in assessment is not attributable to the assessee ;

(ii) Where a person is treated as an agent of a non-resident and is assessed to tax on the income of the latter ;

(iii) Where the assessee has income from an unregistered firm which is treated as registered under Section 183 (b) ;

(iv) Where the previous year is the financial year or any year ending about the close of the financial year and large profits are made after the last instalment fell due in the circumstances which could not have been foreseen ;

(v) any other case in which the I.A.C. considers that the circumstances justify a reduction or waiver of the payment of interest.

Other Provisions : If an assessee fails to pay the advance tax demanded by the I.T.O. nor does he file an estimate, he becomes an assessee in default in respect of the tax so demanded. Further, even after submission of an estimate, if the assessee fails to pay the tax in any of the instalments as per his own estimate, he is deemed to be an assessee in default in respect of the instalments remaining unpaid. As an assessee in default, he attracts liability to penalties and other proceedings against him for the default in payment and for the recovery of taxes under the Act. However, where an assessee defers the payment of tax on commission receipts under Section 213, he is not deemed to be in default till the date on which the deferred tax becomes due expires without payment of the tax, (Section 218). Any tax paid in advance by the assessee is to be adjusted towards the tax payable on regular assessment or on provisional assessment for refund (Section 219).

ties may be levied in addition if it is found that the under estimate or failure to furnish the estimate is deliberate and wilful. The penal interest paid by the assessee in respect of failure to pay or for the shortfall in payment of advance tax is not allowable as a deduction in computing his total income. But the interest paid to the assessee by the Government on the amount of excess payment of tax is chargeable to tax under the head 'Income from other sources'. The details of the provisions relating to the levy of penalty for the non-payment or shortfall in the payment of advance tax have been discussed in Study VI.

(iv) Collection and Recovery of Tax—Other Methods.

Payment of tax and defaults by the assessee (Section 220) : Any tax, interest penalty. fine or any other sum specified in a notice of demand (other than those relating to advance payment of taxes) issued under Section 156 must be paid within 35 days from the date of service of the notice unless a shorter period (not being less than seven days) has been specified in the notice by the I.T.O. with the prior approval of the Inspecting Assistant Commissioner under the Proviso to sub-section (1) of Section 220. The I.T.O. is authorised to extend the time for payment or allow the payment of tax to be made in intalments on receipt of an application from the assessee. Where an assessee, who has been granted permission to pay the tax in instalments defaults in payment of any of the instalments, he will be deemed to be in default in respect of the whole of the amount then outstanding including the other instalments which have not fallen due. An assessee, who fails to pay the tax within the time aforementioned, is deemed to be in default. In that event interest at the rate of 12% per annum after the expiry of 35 days from the date of service of notice to the date of payment of the tax calculated in the manner provided in Rules 118 and 119 of the Income-tax Rules, 1962, shall also be payable in addition to the amount of any penalty for non-payment which may be imposed by the Income-tax Officer.

If the default continues, the Income-tax Officer may start recovery proceeding under Sections 222 to 228 read with the Second Schedule and the Income tax (Certificate Proceedings) Rules, 1962 except in cases (i) where the assessee cannot be treated as being in default or (ii) where the notice of demand was not duly served. However, where the assessee has filed an appeal against the the order of demand made by the I.T.O., he shall not be deemed to be in default in respect of the amount in dispute so long as the appeal is not disposed of. If an assessee has been taxed in respet of his foreign income arising in a country, the laws of which restrict or prohibit the remittance of money into India, he should not be treated as being in default in respect of the tax which is due on the income which, by reason of such prohibitions or restrictions, cannot be and has not been brought into India. For this purpose, the income of the assessee must be deemed to have been brought into

expenditure actually i ncurred by the assessee outside India or if thei ncome, whether capitalised or not has been brought into India in any form.

Any income-tax payable by a person on the amount of income voluntarily declared by him, which is outstanding for payment shall be deemed to be the tax due from the declarant on the date next following the expiry of the period allowed to him for payment and the same will be recoverable as arrears under the provisions of the Act.

Penalty payable (Section 221) : Where an assessee is in default in payment of tax including advance tax and interest payable thereon, the I.T.O. shall impose a a penalty which in cases of continuing default, may be increased from time to time. The I.T.O. should give the assessee a reasonable opportunity of being heard before levying such a penalty. A penalty may be levied on a legal representative for his own default in paying the tax due under an assessment on himself under Section 159 or on the deceased. The penalty levied will be cancelled if the tax to which the penalty relates is wholly and finally reduced in appeal.

No penalty shall be levied on the assessee for default in payment of tax in cases where the I.T.O. is satisfied that the default was for good and sufficient reasons. However, no penalty can be imposed.

(i) for default in payment of a penalty already imposed ;

(ii) where the imposition of penalty does not take the form of an order and the order does not state specifically the sum which the assessee has to pay by way of tax, interest, penalty, etc ;

(iii) where the period specified in the notice has not expired ;

(vi) unless there is default in payment of the tax on the due date ; even if a wrong date is specified in the notice of demand by mistake, no penalty can be levied until the date so specified has expired ;

(v) unless the notice of demand has been properly served ;

(vi) where the assessee has applied for granting stay of recovery proceedings ;

(vii) where the assessee is to be treated as not being in default under Section 220 (6) in respect of a case in appeal ;

(viii) where the assessee has preferred an appeal against the order of assessment or the notice of demand ; and

(ix) where an order of injunction has been issued by a Court restraining the I.T.O. from taking any recovery proceeding. If the I.T.O. is not aware of the order of injunction, the order of penalty passed by him would become void ab initio.

The Explanation to Section 221 (1) provides that an assessee would not cease to be liable to pay any penalty for his default or delay in payment of the tax merely by reason of the fact that before the date of levy of such penalty the tax which was in arrears had actually been paid by him. Thus wherever there is delay on the part of the assessee, he would be liable to penalty even though by the time the Income-tax Officer initiates action for the levy of penalty the amount of tax in arrears is actually paid. An order imposing penalty is appealable and the assessee's right of appeal subject to the condition that he must first pay the tax or penalty : the assessee should first pay the tax before filing the appeal.

Certificate to the Tax Recovery Officer (Sections 222 to 224). On the Income-tax Officer certifying to the Tax Recovery Officer that an amount of tax including advance tax is in arrear from the assessee who is deemed to be in default, the latter would be authorised to take the undermentioned steps in recovery of the tax in accordance with the Rules laid down in the Second Schedule to the Act : (i) to attach and sell any movable or immovable property of the assessee ; (ii) to arrest the assessee and detain him in prison ; (iii) to appoint a receiver for the assessee's movable and immovable property.

[Students may refer to the Second Schedule to the Act for study of the detailed provision relating to the procedure for recovery of tax].

The certificate issued by the I.T.O. shall specify the amount of tax in default the date or dates on which they fell due, the person in respect of whom the proceedings should be taken to recover the same, etc. Such a certificate must be issued by the I.T.O. within one year from the last day of the financial year in which the demand was made or the assessee was deemed to be in default. It is provided further that the mode of recovery of tax through the Tax Recovery Officer is not a bar to the other modes of recovery under the Act. Thus the various methods are not mutually exclusive (Section 222).

According to the new Explanation to Section 222 (1) the power of the tax authorities to attach and sell any movable or immovable property of the assessee for the purpose of collection and recovery of the tax, including penalty, fine or interest payable by the assessee would now extend to assets held by him not only in his own name but also those the income in respect of which is includible in his total income. In other words, the movable or immovable property of the assessee for this purpose must be taken to include also any item of property which has been transferred directly or indirectly by the assessee at any time on or after 1st June, 1973 otherwise than for adequate consideration to his other spouse, minor child, son's wife or son's minor child. So far as the movable or immovable proverty gifted by the assessee to his minor child or his son's minor child is concerned such property must, even after the date of attainment of majority of the child, or grand child as the case may be,

be included in the movable or immovable property of the individual for the purpose of collection and recovery of any of tax due from him in respect of any period. Such a certificate is normally issued by the I.T.O. to the Tax Recovery Officer within whose jurisdiction the assessee resides or carries on his business who can in turn, forward the same to another Tax Recovery Officer in whose jurisdiction the assessee has any property or residence or other belongings. (Section 223).

In cases where an assessee has property within the jurisdiction of more than one Tax Recovery Officer and the Tax Recovery officer, to whom a certificate is sent by an Income-tax Officer is not able to recover the entire amount of the tax due from the assessee by the sale of the property, movable or, immovable, within his jurisdiction or he is of the opinion that, for the purpose of expediting or securing the recovery of the whole or any part of the amount of the tax due from the assessee it is necessary to do, he may send certificate, or where only a part of the amount is to be recovered, a copy of such certificate, certified in the prescribed manner specifying the amount of tax to be recovered, to the Tax Recovery Officer within whose jurisdiction the assessee resides or has got property. On receipt of such a certificate the Tax Recovery Officer to whom the certificate is subsequently issued, will be entitled to recover the amount of tax due from the assessee as if the certificate or the copy thereof had already been sent to him by the Income tax Officer.

During the course of recovery proceedings, the assessee cannot call into question the correctness or validity of the assessments specified in the certificate that Income tax Officer had forwarded to the Tax Recovery Officer. But the Income tax Officer may withdraw the certificate to correct any clerical or arithmetical error therein by making a request in this regard to the Recovery Officer. The I.T.O. is also entitled to stay the execution of the cretificate or to allow payments in instalment or to modify the demand specified therein, if the circumstances so necessitate (Section 224).

Proceedings for the collection and recovery of tax can be taken against an assessee only if : (i) he is actually in default ; or (ii) he is deemed to be in default. Normally no person can be deemed to be in default unless ; (i) he has been duly served with a notice of demand under Section 156 and/or (ii) the requirements of the notice have not been complied with. Even in the case of non-compliance with the notice of demand issued to an unregistered firm a partner of the firm to whom no such notice had been issued can be considered as an assessee in default and the Tax Recovery Officer has jurisdiction to take proceedings against him individually for recovering the tax dues of the firm as was held by the Supreme Court in *Sahu Rajeswar Rath Vs. I.T.O. (1969) 72 I.T.R. 617 (S.C.)* An heir on whom notice of demand has been served even if such a notice has been served on his co-heir cannot however, be proceeded against as an assessee in default in respect of the tax

dues of the deceased. Similarly a tax recovery certificate cannot be issued against the Karta of H.U.F. in his individual capacity in respect of tax payable by the family. The fact that the outstanding tax liability of an assessee has been written off by the department in its accounts does not in any way preclude it from taking recovery proceedings on the assessee.

Other modes of recovery (Section 226 to 229) : Apart from taking steps to recover tax through the Tax Recovery Officer, the Income tax Officer may issue a notice to any person who holds any money belonging to the assessee in default or is likely to hold any such money requiring him to deduct the amount of tax in arrerars therefrom and to pay the same to the Income-tax Officer, from out of the amount held or which shall, at some future date become due to the assessee to the extent specified in the notice served on him. Amounts standing in joint accounts shall also be liable for attachment. The various other modes of recovery of tax are enumerated in Section 226.

Priority as regards recovery of taxes : (Section 226) : Any claim in regard to any property in relation to which a notice under this Section is issued, shall be void as against any demand contained therein. Where a person, on whom a notice (*garnishee order*) under this Section has been served, object on oath that the amount demanded from him is not due to the assessee or that he does not hold any money for or on behalf of the assesse, he cannot be compelled by the I.T.O. to make the paymen t. But if it is later on found that such a statement made by him was false, he would personally become liable to pay the amount to the extent of his own liability to the assessee or to the extent of the assessee's liability whichever is less. Such personal liability world arise even in cases where the person in receipt of a notice from the I.T.O. makes a payment in disregard of the notice served on him.

Moneys belonging to the assessee in default which are in the custody of a Court of Receiver are also liable for the attachment. Further, on being authorised by the Commissioner, the I.T.O. is also empowered to recover the tax by distraint and sale of movable property as laid down in the Third Schedule (Section 226). For details, students may refer to the Third Schedule in the Act. In addition, tax may be recovered through the State Government if the recovery of tax in any area has been entrusted to it under the Constitution. In such a case the State Government may direct that the tax shall be recovered in respect of any particular area together with the municipal taxes or local rates by municipality or local authority (Section 227).

There are reciprocal agreements under which the recovery of Indian tax in Pakistan and Pakistan tax in India may be made by the I.T.O. concerned initiating certificate proceedings to recover the tax in arrears if the assessee of the other co[illegible]ry [illegible] any pr[illegible]rty in th[illegible] other co[illegible]try (Sectio[illegible] 228). T[illegible] above prov[illegible]

relating to recovery of taxes shall apply as well to any sum imposed on the assessee by way of interset, fine, penalty, etc., payable under the Act (Section 229).

Tax Clearance Certificate (Section 230) : Any person domiciled in India is required to obtain a tax clearance certificate from the I.T.O. (Foreign Section) before leaving the country by land, sea or air unless specifically exempt by the Central Government in this regard. Such a certificate is required only if, in the opinion of the I.T.O., the assessee is leaving India with no intention of returning and thus intends to emigrate. The I.T.O. on receipt of an application made by the assessee in this behalf may issue the certificate in accordance with Rules 42 to 44B of the Income-tax Rules, 1962, if he is statisfied that there is no liability to tax outstanding on the part of the assessee or that satisfactory arrangements have been made for the payment of all taxes due or would become due. Further, if the owner or charterer of a ship or aircraft allows a person who is liable to produce a tax clearance certificate to travel out of India without such a certificate, he shall be personally liable to pay the tax payable by such a person. However, if a person not domiciled in India is likely to return to India, the I.T.O may grant him an exemption certificate in respect of a specified period. Such an exemption certificate enables the person to leave India without obtaining a tax clearance certificate.

Persons who are exempt from obtaining tax clearance certificate are :

(i) all persons below the age of eighteen years ;

(ii) persons who are not domiciled in India, provided that the total period spent in India does not exceed ninety days ;

(iii) (a) all persons who are for the time being holding any civil post under the Union or a State Government or a local authority and persons who are for the time being holding posts connected with defence ;

(b) all persons whose salaries or emoluments are fixed by law or are specified in the Second Schedule to the Constitution or are determined under Article 186 or 221 read with Article 238 (8) and 238 (15) respectively :

(c) the wives of the persons referred to in clauses (a) and (b) ;

(d) British Officers and other Ranks proceeding ex-India on termination of their contract of service with the Government of India ;

(iv) (a) all diplomatic envoys of foreign and commonwealth countries accredited to India and their wives ;

(b) Foreign Consular Officers *de carriere* posted in India and their wives ;

(c) Trade Commissioners and Trade Agents *de carriere* of Foreign and Commonwealth countries posted in India and their wives ;

(d) members of the staff of the establishments of any of the officers mentioned in clauses (a), (b) and (c) above, provided they are nationals of the country represented by that officer and the whole time employees of the Government of that country and are not engaged in any private occupation for gain in India and their wives ; and

(e) officials of the United Nations and Specialised Agencies of the United Nations to whom the United Nations (Privileges and Immunities) Act, 1947, is applicable and their wives ;

(v) (a) officials and the representatives of Foreign and Commonwealth Governments visiting India on the business of their Government and their wives ;

(b) officials of foreign and commonwealth governments functioning in India who are exempt from payment of income tax under an agreement entered into between the said Government and the Government of India and the wives of such officials ;

(vi) (a) all persons permitted by the Protector or Emigrants to depart out of India to Sri Lanka, Burma or Malaysia for unskilled work ;

(b) all persons permitted by the Protector of Emigrants under Section 17 of the Indian Emigration Act, 1922 to be recruited for being engaged on skilled work in an overseas country except those in respect of whom the Protector of Emigrants declares that a Tax Clearance or all Exemption Certificate is necessary ;

(vii) (a) all seamen holding Indian Countries Discharge Certificate proceeding from India under an agreement of service with a ship owner or an Agent or Master of a ship, provided that the employers agree to be responsible be for the payment of the tax due from the seamen in respect of their wages ;

(b) all seamen holding Foreign Continuous Discharge Certificate proceeding from India under an agreement of service with a ship-owner or an Agent or Master of a ship, provided that their preceding stay in India was of a duration not exceeding ninety days ;

(viii) (a) all persons proceeding on pilgrimage by sea to the Hejaz, provided that they travel in deck class on pilgrim ships with return tickets, hold pilgrim passes and are not in possession of international passports ; and

(b) all persons proceeding on pilgrimage by sea to Iran and provided that they travel in deck class with return tickets, hold pilgrim passes and are not in possession of international passports.

However, subject to such general or special directions as the Central Government may issue, the competent authority may, at his discretion, require any of the aforesaid persons to obtain from him a tax clearance or an exemption certificate.

Rertriction on registration of transfers of immovable property: Section 230A prohibits the authority concerned from granting registration for any documents purporting to transfer, assign, limit, or extinguish the right, title or interest of any person to or in any property (including agricultural land) valued at more than Rs. 50,000 unless the I.T.O. certifies that the person whose right, title or interest is transferred, assigned or existinguished has either paid or made satisfactory arrangements for the payment of all the existing liabilities under the various direet tax laws or that the registration of the document will not prejudically affect the recovery of the taxes due. The I.T.O. shall not issue such a certificate if he is satisfied that such a transfer is intended to reduce or avoid payment of any existing liability or would make the assessee unable to meet his tax liability, whether existing or future.

Sub-section (3) of Section 230 A confers powers on the Central Board of Direct Taxes to exempt by a notification in the Official Gazette and or reason to be recorded in writing, any institution, association or body or any class of institutions, associations or bodies from the requirement of obtaining tax clearance certificate under this Section. Circular No. 191 dated 4.3.1976 issued by the Board seeks to clarify that in cases where the transferor is the Government, the provisions of Section 230 A would not apply.

Period for commencing recovery proceedings: Under Section 231 the proceedings for the recovery of taxes etc.. shall be commenced only after the expiry of one year from the last day of the financial year in which the demand is made or in which the assessee is deemed to be in default. The period of one year shall be reckoned as under :

(i) where an appeal has been made on the order of demand issued by the I.T.O. and the assessee has been held as not being in default till the disposal of the appeal from the last day of the financial year in which the appeal was disposed of ;

(ii) where recovery proceedings in any case have been stayed by an order of a Court—from the last day of the financial year in which the stay order was withdrawn ;

(iii) where the date of payment of tax has been extended by the income-tax authority to any date—from the last day of the finacial year in which the extended date falls ;

(iv) where the amount is allowed to be paid in by instalments from the last day of the financial year in which the last of such instalments became

due. Even if some action is taken to recover the whole or any part of the sum in arrear within the time specified above, the proceedings for recovery shall be deemed to have been commenced in full.

The above limitations do not, however, apply to the recovery of taxes in respect of a non-resident from his assests in India or to a case where the tax in arrear relates to income arising to the assessee in a foreign country the laws of which restrict to prohibit its remittance into India until such restrictions are removed.

Other Provisions : Section 232 provides that the I.T.O. or the Government can have recourse to the other modes of recovery under any other law for the time being in force over and above the various modes specified above to recover the tax dues under the Act in the same way as other debts due to the Government. It shall also be lawful for the I.T.O. or the Government to have recourse to any other law or file a suit in any manner for the recovery of the arrears due from the assessee.

The tax deducted at source or paid in advance shall be deemed to have been paid towards provisional or self-assessment (Section 234).

4. **REFUNDS** (Section 237 to 243)

An assessee is entitled to claim a refund of tax if the tax actually paid (and not merely payable) by him or on his behalf for any assessment year exceeds the amount of tax with which he is properly chargeable under the Act for that year. This may arise usually as a result of excess deduction of tax at source from salaries, dividends, interest, to or as a result of excess payment of advance tax when the tax originally paid on assessment is reduced on appeal, revision, rectification or reference. Where such a claim for refund is made, the assessee cannot question the correctness or validity of the assessment or any other matter related thereto which has become final and conclusive. He is also debarred from asking for a review or revision of the assessment (Section 237 and 242).

In case where the payer of income from salary, dividend, interest or other sum has wrongly deducted tax at source and paid the same to the credit of the Central Government, then it is the payer of the income who wrongly deducted tax (and not the recipient) who will be entitled to claim the refund provided that the recipient is neither taxable on the gross income nor entitled to credit in respect of the tax deducted. Where the tax payable by all unregistered firm is recovered from its partners the tax should be treated as having been paid by the firm and consequently, the application for refund must be made by the firm and not by the partner from whom the tax was recovered. In respect of tax free income (*i.e.* where salary, annuity, interest etc. is paid tax free) the amount of tax is included in the recipient's total income by adding it to the net income received ; since the tax in such cases is

deemed to have been deducted and paid on behalf of the recipient of the income, he would be entitled to claim a refund if the tax so paid is in excess of the amount with which he is properly chargeable.

Generally, a claim for refund can be made only by the person on whose account the tax was already paid. But in cases where the income of one person is included in the total income of another person under Sections 60 to 65, the latter person alone is entitled to claim the refund. I' any person is not able to claim or receive the refund due to him on account of his death, mental incapacity, insolvency, dissolution, liquidation, etc., his legal representative or trustee, guardian liquidator or receiver, as the case may be, is entitled to claim or receive the refund on behalf of such person (Section 238).

All claims of refunds should be made in the prescribed form (Form No. 30) and verified in the prescribed manner in accordance with Rule 41 of the Income-tax Rules and shall be accompanied by the return of income except in cases where such a return had alrealy been filed. The requirements of the Rule are mandatory in nature and if an application 'or refund is not in compliance with the requirement of the Rule, it would be invalid and, consequently, will not be entertained by the Department nor can the assessee appeal against the Department for refusing to entertain the same. The claim for refund should be supported by the certificates of tax deducted at source. The claim may be presented by the claimant in person or through a duly authorised agent or may be sent by post.

The time-limit for making application for refund is two years from the end of the relevant assessment year. (Section 239).

The Court has no power to extend this period of limitation in any case. This period of limitation would not, however, apply to cases where a refund becomes due to the assessee as a result of an order in appeal, reference, revision or making any reassessment ; but in cases where the refund is due to the assessee on the basis of the completed regular (but not provisional) assessment, the assessee may file a suit for the refund due to him if it is not granted on his application or he may file a petition for a *writ of mandamus* to compel the Department to make the refund. Where the refund becomes due to the assessee as a result of an order passed in appeal, reference, revision or rectification, he need not make an application to claim the same. In such a case, the I.T.O. is bound to pass an order of refund without waiting for the application from the assessee. (Section 240).

The I.T.O. is entitled to withhold a refund, after getting the prior approval of the Commissioner, in cases where the order giving rise to the refund is the subject matter of an appeal or further proceeding under the Act which is still pending or where, in his opinion, the grant of such refund is likely to affect the Revenue adversely. This power can be exercised by the I.T.O, only till such time as the Commissioner may determine (Section 241).

Section 243 provides for the payment of interest on delayed refunds. The I.T.O. shall grant the refund claimed by the assessee within a period of six months from the date of the claim where the total income consists solely of interest on securities or dividends and three months from the date on which the total income is determined in other cases. If the refund is granted within the 6 or 3 months time stated above, simple interest @ 12% p.a. shall be payable on the amount of refund from the date following the expiry of the aforesaid 6 or 3 months period, as the case may be, to the date of granting the refund.

Under Section 243, interest is payable by the Government only in cases where the refund is not granted within three months from the date on which the total income is determined. The interest wherever payable is to be calculated from the date immediately following the expiry of the three months aforesaid to the date of order granting the refund. From this it is clear that date of the order of assessment should not be taken as the date of the order granting the refund. Thus in all cases where interest is payable by the Central Government to assessees, such interest is to be calculated for the period commencing from the date of determination of the total income to the date of issue of the refund voucher. The interest should be calculated in the manner specified in Rule 119A.

In a case where the total income of the assessee consists only of interest on securities or dividend or both, interest will be payable by the Central Government for any delay in the grant of refund, beyond the period of three months from the end of the month in which the claim for refund is made, as against six months from the date of the claim under the existing law. In all other cases or delay in the grant of refund interest will be payable by the Central Government for period of delay beyond three months from the date of the assessment order under the existing provision. In computing the period of delay in granting refund, the period of delay attributable to the assessee whether wholly or in part, must be excluded.

According to Section 244, where a refund arising out of an order in appeal is not paid within 3 months from the date of such order, simple interet @ 12% p.a. will be payable to the assessee. The interest is to be calculated from the date of expiry of the aforesaid six months to the date of granting the refund. Interest will be payable by the Central Government to the assessee for the period of delay in the grant of refund arising as a result of an order in appeal or other proceeding under the Act beyond three months from the end of the month in which the appellate order is received by the Commissioner or, as the case may be, the order in revision or other proceeding giving rise to refund is passed.

In cases where the whole or any part of the amount of refund is due to the assessee as a result of any amount having been paid by him at any time after 31st March, 1975 in pursuance of any order of assessment or penalty and such an

amount or part thereof having been found, on appeal or in other proceedings under the Act, to be in excess of the amount which the assessee is liable to pay by way of tax and/or penalty as the case may be, the Central Government shall pay to such an assessee simple interest at the rate of 12% on the amount so found to be in excess from the date on which the amount was paid by the assessee to the date on which the refund is actually granted. However, in cases where the amount so found to be in excess was paid in instalments, then, such interest would be payable on the amount of each such instalment or any part thereof which was in excess from the date on which the instalment was paid to the date on which the refund is granted. But no interest would be payable to the assessee for a period of one month from the date of passing of the order in appeal or other proceeding as a result of which the refund becomes due. In cases where any interest is payable to the assessee under the new sub-section (IA), no interest would be payable in respect of the same amount under sub-section (1) as part of the refund due to the assessee in the normal course.

Where a refund is withheld by the I.T.O. under Section 241, (because of the order giving rise to the refund being the subject matter of an appeal or other proceeding) simple interest @ 12% p.a. shall be payable on the amount ultimately found to be refundable after the expiry of three months from the date of the official order giving rise to the refund to the date of granting the refund. The Central Government will be liable to pay intereat in such cases for the delay in granting the refund beyond the period of three months from the end of the month in which the order giving rise to the refund was passed. The I.T.O./A.A.C. or the Commissioner is entitled to adjust the amount of refund or part thereof against any amount due from the person to whom such a refund is to be made after giving a written intimation to him (Section 245).

Time-limit : Any rectification of mistake apparent from the record can be made by the authority concerned only within a period of four years from the date of the order sought to be rectified. However, once the order of rectification is passed within the time-limit allowed under the Section, the consequential order of refund or demand for payment of tax may be made even after the period of limitution. The period of four years also applies in cases where a rectification is sought to be made by the Appellate Tribunal. In particular, Section 154 (7) specifically provides that the period of four years shall be reckoned from the date of the final order on the basis of which the amendment or rectification became necessary.

The assessee is given an express right of appeal under Section 246 (f) against any order of rectification or amendment passed by the I.T.O. under Sections 154 and 155. But an order of rectification does not in any way affect or extend the period of limitation for an appeal against original order of assessment.

Other provisions : In all cases where an assessment or reassessment is completed and any tax, interest, penalty, fine or any other sum is payable by the assessee, the I.T.O. shall serve upon the assessee a notice of demand in Form No. 15 (Form No. 16 in the case of an order on provisional assessment) specifying the sum so payable. Though the Act does not prescribe any time limit within which a notice of demand should be served on the assessee, the notice of demand must be issued within a reasonable time (Section 156). Likewise, where the assessment results in a loss and such loss is to be carried forward, the I.T.O. shall notify to the assessee by an order in writing the amount of such loss computed by him (Section 157). In cases, where a registered firm is assessed or an unregistered firm is assessed under-Section 183 (b) as registered, the I.T.O shall notify to the firm, by an order in writing the amount of total income assessed and its apportionment amongst the several partners (Section 158). The assessee has a right of appeal against any order passed by the I.T.O. under Sections 157 and 158.

SELF-EXAMINATION QUESTIONS

These questions are intended to enable the student to test his knowledge before proceeding to answer the test paper. Answers to these questions are not required to be written or submitted for evaluation.

1. The return of income in the case of person getting income from salaries is to be filed during the assessment year before (a) 30th September (b) 30th June. (c) 31st March.

2. An assessee deriving income from business or profession should file his return of income within four months from the end of his latest previous year. But in all other cases the return should be filed before (a) 30th June (b) 30th September (c) 31st December (d) 31st July. ( )

3. The I.T.O. can extend the time for filing a return. In all cases where an extension is granted interest is chargeable at the rate of (a) 10% (b) 6% (c) 9% (d) 4% (e) 12%.

4. The interest chargeable for delay in filing return is (a) mandatory (b) at the discretion of the I.T.O. (c) subject to the approval of the Commissioner (d) subject to the Rules.

5. A belated return for the assessment year 1975-76 or later year may be filed at any time before the expiry of (a) three years (b) four years (c) two years eight years from the end of the relevant assessment year. ( )

6. The time-limits for issue of notice to bring to charge an item of income escaping assessment in any year is (a) 4 years (b) 8 years (c) 16 years (d) 2 years (e) one year.

(i) where the escaped income exceed Rs. 50,000 ( )

(ii) where the escaped income is less than Rs. 500,000 ( )

(iii) where income has escaped by reason of no omission or failure on the part of the assessee ( )

(iv) where the assessee is the agent of non-resident whose income has escaped assessment. ( )

7. The permission of (i) the Board or (ii) the Commissioner is essential in cases where the notice to assessee the escaped income is issued after the expiry of 4 years (b) 3 years (c) 16 years (d) one year. ( )

8. An assessment or reassessment of escaped income should be made within— ( )

(i) if the case falls under Section 147 (a). ( )

(ii) if the case falls under Section 147 (b)

(a) 8 years (b) 4 years from the end of the assessment years in which notice was served (c) 4 years from the end of the year in which the income was assessable or one year from the date of service of notice whichever is less (d) 16 years.

9. An order of fresh assessment on cancellation of the original assessment on appeal, revision or references should be made within a period of (a) 4 years (b) 2 years (c) 8 years (d) one year from the end of the financial year in which the order in appeai, reference or revision was passed. ( )

10. The time-limits for rectification of any mistake apparent from the records is—(a) 8 years (b) 4 years (c) one year (d) 2 years. ( )

11. The appeal to the Appellate Assistant Commissioner must be made within a period of (a) 60 days (b) 15 days (c) 3 months (d) 30 days from the date of receipt of the I.T.O.'s order of assessment. ( )

12. The appeal to the Appellate Tribunal must be made within a period of (a) 60 days (b) 30 days (c) 3 months from the date of receipt of the order sought to be appealed against. ( )

13, A memorandum of cross-objections can be filed by the assessee or the Commissioner on receipt of the notice of appeal within a period of (a) 60 days (b) 3 months (c) 15 days (d) 30 days. ( )

14. For requiring the Tribunal to refer a case to the High Court the assessee or the Commissioner should apply to the Tribunal within (a) 30 days (b) 60 days (c) 6 months (d) 3 months of the date of the order of the Tribunal. ( )

15. On receipt of an application the Trib unal must make a statement of the case and refer it to the High Court within a period of (a) 60 days (b) 120 days (c) 30 days (d) 6 months.

16. If the Tribunal refuses to state and refer the case to High Court the assessee or the Commissioner may apply to the Court requesting it to require the

Tribunal to refer the case to it. Such an application may be made within a period of (a) 6 months (b) 30 days (c) 60 days (d) 3 months.

17. Where the *Tribunal refuses to refer the* case to the High Court the assessee may withdraw his application and will be entitled to a refund of the fees paid by him if the withdrawal is made within a period of (a) 3 months (b) 60 days (c) 30 days (d) 6 months.

18. The Commissioner has no power to revise an order prejudicial to the Revenue passed under (a) Section 144 (b) Section 147 (c) Section 104 (d) Section 143.

19. An order prejudicial to the Revenue cannot be revised by the Commissioner after the expiry of (a) two years (b) one year (c) six months (d) four years from the date of the order sought to be revised.

20. The maximum penalty imposable and additional penalty per day for continuing default for failure to furnish information regarding securities etc., as required by a notice under Section 94 (6) shall be (a) Rs. 100 (b) Rs. 250 (c) Rs. 500 (d) Rs. 1,000.

21. Penalty for failure to comply with a notice under Sections 132 (1), 142 (2A) and 143 (2) will be—

(i) Minimum (ii) Maximum ( )

(a) 10% of the difference between the tax on the assessed income and the returned income (b) 50% of the tax payable (c) 50% of the difference between the tax on the assessed income and the returned income (d) 10% of the tax payable.

22. The penalty for concealment of particulars of income for furnishing inaccurate particulars will be—

(i) Minimum (*ii*) Maximum ( )

(a) 10% (b) 100% (c) 150% (d) 200% of the tax sought to be evaded.

23. No penalty can be imposed in cases where the total income determined on assessment does not exceed the maximum amount not chargeable to tax in the case of the assessee by—

(a) Rs. 10,000, (b) Rs. 5,000 (c) Rs. 2,500 (d) Rs. 1,500.

24. Where the assessee who has failed to comply with a notice issued to him under Section 130 (1) proves that he has no income liable to tax the penalty imposable on him shall not exceed—

(a(Rs. 100 (b) Rs. 150 (c) Rs. 25 (d) Rs. 500.

25. If the profits of a registered firm are distributed otherwise than in accordance with partnership deed the penalty leviable on the partner would be a maximum (a) 100% (b) 150% (c) 200% (d) 10% of the tax which would have been avoided had the income returned by him been taken as the correct income.

26. The penalty leviable for failure to give notice of *discontinuance of the* business or profession is—

(i) Minimum (ii) Maximum ( )

(a) 100% (b) 10% (c) 15% (d) 200% (e) 50% of the tax on the income from the business or profession to the date of discontinuance.

27. The penalty imposable for furnishing a false estimate of advance tax payable is—

(i) Minimum (ii) Maximum ( )

(a) 10% (b) 100% (c) 150% (d) 200% of the difference between 75% the assessed tax minus advance tax paid during the previous year or the tax payable or the latest assessment of self assessment (whichever is greater minus advance tax paid during the previous year whichever is less or the amount demanded by a notice by the I.T.O. whichever is less.

28. The penalty for failure to furnish an estimate of advance tax payable under Section 212 (3) or Section 209A (1)

(i) Minimum (ii) Maximum ( )

(a) 100% (b) 10% (c) 230% (d) 150% of 75% the assessed tax.

29. Where penalty for concealment of income is to be levied, an assessee who assessed income exceed Rs. 25,000 the I.T.O. must refer the case to the (a) Inspecting Assistant Commissioner (b) Appellate Assistant Commissioner (c) Commissioner (d) Board.

30. The time limit for levying penalty is (a) 4 years (b) 6 years (c) nil (d) 2 years from the date of the completion of the proceedings in the course of which the proceedings for imposing penalty have been initiated.

31. The assessee's application for revision of any order to the Commissioner must be made within a period of (a) 2 years (b) one year (c) 60 days (d) 4 years from the date of receipt of the order sought to be revised.

32. Any application to the Commissioner for revision of any order must be accompanied by a fee of (a) Rs. 25 (b) Rs. 125 (c) Rs. 100 (d) Rs. 200 (e) Rs. 250 ;

33. Tax is not deductible at source in respect of income from (a) salaries (b) royalties (c) selling commission (d) fees (e) interest (f) dividends (g) rent.

34. Tax should be deducted at source in respect of payments out of accumulated balance due to an employee from a recognised provident fund or an approved superannuation fund by—

(a) the employer (b) the employee (c) the trustes (d) the Government (e) the Provident Fund Commissioner.

35 Tax is to be deducted at source from interest [illegible] than on securities only if the payment in the aggregate exceeds—

(a) Rs. 400 (b) Rs. 500 (c) Rs. 250 (d) Rs. 1,000 ( )

36. The rate at which tax is to be deducted from interest (other than on securities is—(a) 10% (b) 20.5% (c) 25% (d) 23%. ( )

37. Tax is not deductible at source from interest payable by—

(a) companies (b) firms (c) individuals (d) Hindu undivided families ( )

38. Certain items of income other than interest on securities or dividends are subject to deduction of tax if they are payable to

(a) all resident assessees (b) non-resident persons (c) not ordinarily residents (d) domestic companies. ( )

39. The person responsible for deduction of tax at source in the case of a company is—(a) the principal officer (b) the director (c) the manager (d) the shareholders. ( )

40. Income subject to advance tax should be computed after excluding—

(a) business income (b) speculation profits (c) capital gains income by way of winnings from lotteries, race winnings, etc. (d) salaries. ( )

41. Advance tax is to be paid in instalments by an assesse following (i) the calendar year and (ii) the financial year as his accounting year on—

(a) 15th June, 15th September and 15th December (b) 15th September, 15th Dec. and 15th March (c) 1st April,, 1st June, 1st September and 1st March (d) 1st May, 1st August, 1st December, 1st February. ( )

42. What would be your answer if in the above case the assessee's acounting year ends on 28th February ? ( )

43 Interest payable by the assessee and the Government in respect of short fall in the payment of advance tax is @ (a) 6% (b) 9% (c) 12% (d) 4%. ( )

44. An assessee is under an obligation to file an estimate of his current income even if he paid advance tax on the basis of a demand from the I.T.O. in all cases where the tax on the current income is likely to exceed that payable as per the notice of demand or earlier estimated by—

(a) 95% (b) 30% (c) 33 1/3% 20% in the case of company (d) 50 %.

ANSWERS

1. (b) ; 2 (a) ; 3, (c) ; 4, (a) ; 5. (c) ; 6, (i), (c) ; (ii), (b) ; (iii), (a) ; (iv), (d) 7 (i), (b) ; (ii), (a) ; 8 (i), (b) ; (ii) (c) ; 9, (b) : 10 ; (b) ; 11, (d), 12 (a) ; 13, (d) ; 14 (b) ; 15 (b) : 16 (a) : 17, (c) ; 18, (b) ; 19 (a) ; 20, (c) : 21, (i) (a) ; (ii) (c) 22, (i), (b) ; (ii), (d) ; 23, (d) ; 24 (c) ; 25, (b) ; 26, (i) (b), (ii), (a), 27, (i), (ii), (c) ; 28 (i) (b); (ii), (d) ; 29 (a) 30; (b) ; 31, (b) ; 32 (a), 33, (b) (c) (d) and (f) if they are not covered by Section 195, 34, (c) 35, (d), 36, (a) & (b), 37, (c) & (d), 38 (b), 39, 40 (c), 41 (a) (ii) (b) 42 (b), 43 (c), 44 (d).

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(a) 95% (b) 30% (c) 33 1/3% 20% in the case of company (d) 50 %.

ANSWERS

1. (b) ; 2 (a) ; 3, (c) ; 4, (a) ; 5. (c) ; 6, (i), (c) ; (ii), (b) ; (iii), (a) ; (iv), (d) 7 (i), (b) ; (ii), (a) ; 8 (i), (b) ; (ii) (c) ; 9, (b) : 10 ; (b) ; 11, (d), 12 (a) ; 13, (d) ; 14 (b) ; 15 (b) : 16 (a) : 17, (c) ; 18, (b) ; 19 (a) ; 20, (c) : 21, (i) (a) ; (ii) (c) 22, (i), (b) ; (ii), (d) ; 23, (d) ; 24 (c) ; 25, (b) ; 26, (i) (b), (ii), (a), 27, (i), (ii), (c) ; 28 (i) (b); (ii), (d) ; 29 (a) 30; (b) ; 31, (b) ; 32 (a), 33, (b) (c) (d) and (f) if they are not covered by Section 195, 34, (c) 35, (d), 36, (a) & (b), 37, (c) & (d), 38 (b); 39, 40 (c), 41 (a) (ii) (b) 42 (b), 43 (c), 44 (c).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL F.S.P. (N) I. Tax.—5

FINAL COURSE (N)

INCOME-TAX

STUDY PAPER V

ASSESSMENT PROCEDURES REGARDING SPECIFIC TYPES OF ASSESSEES

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ASSESSMENT OF INDIVIDUALS

Meaning and scope of the term 'individual' : The 'individual' assessee is the back-bone of the income-tax system. The income may be earned collectively but on its distribution amongst the co-sharers it becomes their personal income. On this account, the income when it is earned jointly, first suffers tax depending on its character, *i.e.*, as the income of association by which it was earned, and again on its distribution amongst the members of the organisation as their personal income. In a sense, therefore, the *individual in the case of income earned collectively has to pay tax twice, first collectively and on the second time individually.* For example, the income-tax paid by a firm, an association of persons or a company is in effect borne by the body of individuals entitled to share its income. Under the income-tax law an individual being an assessable entity separate and distinct from the firm in which he is a partner or the company in which he is a shareholder, when he receives his share of income from any of the entities, he once again is called upon to pay income-tax thereon *unless specifically exmpted* An exémption is not generally available on the ground that the income which he is receiving has already suffered tax. There are, however, certain exceptions to this rule providing tax concessions in respect of the income received by a member from a firm or an association of persons. These have been discussed later on in this Study Paper at their appropriate places.

The term "*individual*" as such has nowhere been defined in the Income-tax Act. Section 2(31), however, states that 'person' includes an individual. In the commonly understood sense of the term an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an "individual" and is liable to pay tax, if the total income earned by him during any previous year exceeds the prescribed limit exempted from tax. If an individual who is liable to pay tax, for any year, dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person. In the case of an individual who is a minor or a lunatic the assessment of his income will be made on his guardian or trustee. However, if the incapacitated person has no trustee or guardian or trustee or guardian is a non-resident in India and cannot be traced, the assessment can be made directly on the minor or lunatic. The rights and duties of all representative assessees are the same as those of the persons they are representing.

Total income of an individual : The total income of an individual for any previous year, which is liable to tax, is to be computed under the various heads discussed in Study Papers II and III according to the principles explained Study Paper I. Further Sections 60 to 65 of the Income-tax Act provide that in computing the total income of an individual for the purpose of assessment there shall also be included all the income specified therein that arises, directly or indirectly, to specified persons as a result of a transfer of any asset or the share income of the spouse or minor child for the firm in which he is also partner etc. These provisions are designed to check attempts of an individual to avoid or reduce the incidence of tax by transferring his assets or income to other persons. Special attention has been given to the transfer of assets to spouse or minor child, daughter-in-law or minor grand children or by admitting the spouse as a partner or the minor child to the benefits of partnership in a firm in which such individual may or may not be a partner. These provisions must be strictly construed inasmuch as they create an

artificial liability to tax. Students may refer to the discussion of this topic contained in Study Paper I for a detailed study of these provisions.)

A married woman, being an individual, is liable to income tax in respect of the total income of any previous year arising to her in her own right, including the income from assets inherited by her or gifted to her by person other than her husband or her father-in-law or mother-in-law.

Rates of tax applicable to individuals: The rates of income-tax applicable to individual and other assessees like HUFs other than those having one or more members with independent taxable income, unregistered firms or other association of persons or body of individuals, or artificial juridical persons, are specified in Paragraph A of part I of First Schedule to the Finance Act, 1984. The rates of tax applicable to individuals are progressive in nature *i.e.* the rates increase with an increase in income at the appropriate slab and are exactly opposite to those applicable to companies which are subject to a flat rate of tax.

Accordingly, for the purposes of computing the tax payable for the assessment year 1984-85, the following rates of tax will have to be applied ;

Income	*Rates of tax*
Where the total income does not exceed Rs. 15,000	Nil
Where the total income exceeds Rs. 15,000 but does not exceed Rs. 20,000	25 per cent of the amount by which the total income exceeds Rs. 15,000 ;
Where the total income exceeds Rs. 20,000 but does not exceed Rs. 25,000	Rs. 1250 plus 30 per cent of the amount by which the total income exceeds Rs. 20,000.
Where the total income exceeds Rs. 25,000 but does not exceed Rs. 30,000	Rs. 2750 plus 35 per cent of the amount by which the total income exceeds Rs. 25,000 ;
Where the total income exceeds Rs. 30,000 but does not exceed Rs. 50,000	Rs. 4,500 plus 40 per cent of the amount by which the total income exceeds Rs. 30,000 ;
Where the total income exceeds Rs. 50,000 but does not exceed Rs. 60,000	Rs. 12,500 plus 50 per cent of the amount by which the total income exceeds Rs. 50,000 ;
Where the total income exceeds Rs. 60,000 but does not exceed Rs. 70,000	Rs. 17,500 plus 52.5% of the amount by which the total income exceeds Rs. 60,000.
Where the total income exceeds Rs. 70,000 but does not exceed Rs. 85,000	Rs. 22,750 plus 55 per cent of the amount by which total income exceeds Rs. 70,000
Where the total income exceeds Rs. 85,000 but does not exceed Rs. 1,00,000	Rs. 31,000 plus 57.5 per cent of the amount by which the total income exceeds Rs. 85,000
Where the total income exceeds Rs. 1,00,000	Rs. 39,625 plus 60 per cent of the amount by which the total income exceeds Rs. 1,00,000.

Surcharge on income-tax : The amount of Income-tax calculated on the total income [including the net agriculture income wherever includible for rate purposes] at the rates applicable to the assessee has to be increased by a surcharge for purposes of the Union at the rate of 12½% of such income-tax in the case of assessees who are individuals, H.U.F., unregistered firms, other associations of persons or bodies of individuals, whether incorporated or not, local authorities and artificial juridical persons.

Part III of the First Schedule to the Finance Act 1984 has prescribed rates for the purposes of deduction of tax at source from salaries, advance tax payment. and assessment in certain special cases for the financial year 1984-85 (assessment year 1985-86). The following cases have been effected from the rate schedule applicable to assessment year 1984-85.

Slabs

1984-85	*Rates*	*1985-86*	*Rates*
Upto 15,000	Nil	Upto 15,000	Nil
15,001-20,000	25%	15,001-20,000	20%
20,001-25,000	30%	20,001-25,000	25%
25,001-30,000	35%	25,001-30,000	30%
30,001-50,000	40%	30,001-40,000	35%
50,001-60,000	50%	40,001-50,000	40%
60,001-70,000	52.5%	50,001-70,000	45%
70,001-85,000	55%	70,001-1,00,000	50%
85,001-1,00,000	57.5%	over 1,00,000	55%
Over 1,00,000	60%		

The rate of surcharge @ 12.5% remains the same.

It must be noted that an individual is liable to pay tax in respect of the following incomes :

(1) incomes earned by the individual himself ;
(2) share of income from a firm ;
(3) share of income from an association of persons ;
(4) income of other persons included in his income under Sections 60 to 65.

The following incomes are however, included in the total income of an individual for rate-purposes only ;

(1) interest from tax-free government securities ;
(2) profit from unregistered firm assessed as such ;
(3) income from an association of persons.

Assessment of Non-resident Individuals : The tax structure explained above is also applicable to an individual, who is a non-resident during the previous year. The scope of income taxable in the hands of a non-resident as laid down in Section 5 has already been explained in Study Paper I.

Section 9 (1) of the Act which extends, the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India, are deemed to be so accruing or arising, assumes special significance in the assessment of non-resident individuals For a detailed consideration of the provisions of Section 9, students are advised to refer to Study Paper I.

Special Provisions Relating to Certain Incomes of Non-Residents

Introduction of Chapter XII A

The Finance Act 1983 has inserted a new chapter XII A in the Income Tax Act w.e.f. 1.6.1983. It contains special provisions relating to certain incomes of non-residents. [Sections 115C-115I].

This Chapter seeks to lay down a concessional method of taxation of certain specified income of Non-Residents. For this purpose, a non-resident Indian means a non-resident individual who may either be an Indian citizen or a person of Indian origin. A person shall be deemed to be of Indian origin if he or either of his parents or any of his grand-parents was born in undivided India.

'Foreign exchange asset' means any 'specified asset' which the assessee has acquired, purchased with or subscribed to in convertible foreign exchange. Such 'specified assets' are as follows :

(a) shares in an Indian Company.
(b) debentures issued by an Indian Company which is not a private company as defined in the Companies Act, 1956.
(c) deposits with a non-private Indian company.
(d) any specified securities of Central Government.
(e) units of the Unit Trust of India.
(f) such other assets as may be notified by the Central Government.

The income derived from such a foreign exchange asset is called investment income.

Flat rate for investment income and long-term capital gains

Where the total income or such a non-resident Indian consists only of investment income and capital gains arising out of the transfer of long-term foreign exchange assets, such income will suffer tax at a flat rate of 20 per cent plus 2.5 per cent surcharge.

Where the total income includes any other income, while tax on income described above is chargeable at 20 per cent, tax on other income will be calculated as per the rates prescribed by the relevant Finance Act.

Exemption on capital gains arising from transfer of long-term foreign exchange asset

Where the non-resident Indian transfers the original foreign exchange asset and within a period of six months of such a transfer deposits or invests the whole or part of the net consideration in

(a) any specified asset or
(b) non-resident (External) Account or
(c) any notified savings certificates then, the capital gains arising on such a transfer will be dealt with as follows :

(1) If the cost of the new asset, referred to in (a), (b) or (c) above, is not less than the net consideration in respect of the original asset the whole of such capital gain shall be exempt. If such cost is less than the net consideration, the exemption will be limited to :

$$\text{Total Capital gain} \times \frac{\text{cost of new asset}}{\text{net consideration}}$$

Note : 1. When the new asset consists of deposits, the cost means the amount of such deposits.

2. **Net consideration means the full value of the consideration received or** accruing as a result of the transfer as reduced by any expenditure incurred wholly and exclusively in connection with such transfer,

Forfeiture of exemption : Where the new asset is transferred or converted (otherwise than by transfer) into money, within a period of three years from the date of its acquisition, the capital gain, exempted as above, shall be chargeable as long-term capital gain of the previous year in which the new asset is transferred or converted,

Return need not be filed: Where the total assessable income of the non-resident during the previous year consisted *only* of investment income and long-term capital gains relating to foreign exchange assets and tax on such income has been deducted at source then he need not file a return of income under section 139 (1)

Benefit available even after the assessee becomes a resident

Where a person, who is a non-resident Indian in any previous year, becomes assessable as resident in India in respect of the total income in any subsequent year, he may furnish a declaration along with such a return to the effect that the provisions of this chapter shall continue to apply to him in relation to the investment income derived from any foreign exchange asset being debentures, deposits, securities of Central Governments and such other notified assets. If he does so, then these provisions will continue to apply to him till such assets are transferred or otherwise converted into money.

Option to the assessee : A non-resident Indian may elect not be governed by these provisions. For this purpose he has to file a declaration to that effect along his return of income under Section 139, for the relevant assessment year. In such a case the total income and tax payable thereon will be computed in accordance with the other provisions of this Act and consequently, the provisions of this chapter will not apply to such non-resident assessees.

Special concessions in the case of individuals not being citizens of India: Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income tax Act, however, on a consideration of the peculiar circumstances in which foreigners come to or live in India, certain concessions and relief are granted to them. These have been discussed in detail in Study Paper I under the head 'Incomes not includible in the total income' [Section 10 (6)].

Exemptions and reliefs available to individuals : The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories :

1. Income altogether excluded from the total income, and on which in consequence, no income-tax is payable. [Section 10].
2. Deductions from gross total income both in respect of income a part of which is not chargeable to income-tax and payments made by the assessee a part or the whole of which is deductible from the gross total income [Chapter VIA.]
3. Rebates in respect of income already taxed and income exempt from tax. [Section 86].

I. Incomes that are not to be included in the total income have already been dicussed in Study Paper I.

DEDUCTIONS FROM GROSS TOTAL INCOME

(Students may note that in the following pages the deductions available to *all* the tax-payers are discussed. A separate classification of these deductions as applicable to different categories of tax-payers can be found in the following pages).

Chapter VIA of the Income-tax Act, 1961 deals with the various deductions that are admissible from the gross total income of an assessee in the computation of total income.

General Provisions : Section 80A (i) provides that in computing the total income of an assessee, there shall be allowed from his gross total income the deductions specified in sections 80C to 80VV.

According to section 80A(2) the aggregate amount of the deductions under this chapter shall not, in any case, exceed the gross total income of the assessee. Thus an assessee cannot compute a minus figure i.e. a loss as a result of the deductions under chapter VIA and claim to carry forward the same for the purpose of set-off against his income in the subsequent year. The only exception to this rule is the carry forward of the unabsorbed portion of the tax-holiday benefit i.e. the "deficiency" under section 80 J(3). Consequent to the introduction of the provisions of Section 80I, even this exception has got only limited applicability now.

Section 80A(3) provides that where a deduction is admissible under Chapter VI-A in computing the total income of a firm, association of persons or body of individuals, no deduction under the same section shall be allowed in computing the total income of a partner of the firm or a member of the association or body, in relation to his share in the income of the firm, association or body. This is to prevent duplication of deductions.

(i) **Insertion of Section 80AA** : *In Cloth Traders Pvt. Ltd.* v. *Additional C. I. T. (1979 118 I. T. R. 243,* the Supreme Court has held that the deduction admissible in respect of inter corporate dividends has to be calculated with reference to the gross amount of dividend received by a domestic company from an Indian company and not with reference to the dividend as computed in accordance with the provisions of the Income-tax Act i.e. after making deduction provided under the Act in respect of items like interest paid on borrowings utilised for the purchase of shares, etc. Since the Government's intention has always been to grant the deduction at the specified percentage on the *net* income of such dividend and *net* on the *gross* amount of such dividend, the Finance (No. 2) Act, 1980 has inserted a new Section 80AA with *retrospective effect* from 1st April, 1968, i.e., the date of insertion of Chapter VIA of the Income-tax Act. The new Section provides that deduction under Section 80M in respect of inter-corporate dividend will be calculated with reference to the dividend income as computed in accordance with the provisions of the Income-tax Act and *not* with reference to the *gross* amount of such dividend as a result of this amendment with effect from the assessment year 1968-69 and the subsequent years, the deduction will be calculated with reference to net amount of such income.

In order to preserve the sanctity of the ruling of the Supreme Court, the Finance Act has made a saving provision to provide that the new provisions of

Section 80AA will not apply to the assessment of an assessee for a particular assessment year, where the Supreme Court has, on appeal or reference in respect of the assessment of the assessee for that year; held before 18th June, 1980 i e., on the date on which the Finance (No. 2) Bill 1980 was introduced in the Parliament that the deduction in respect of inter-corporate dividend should be allowed with reference to the particular year of assessment for which the Supreme Court has given a judgement adverse to the revenue on an appeal or reference made to the Court. The saving provision will not, therefore, apply in relation to cases whether neither the assessee nor the revenue had gone up in appeal or reference to the Supreme Court.

(ii) **Insertion of Section 80AB** : Though the Supreme Court decision in *Cloth Traders Case* concerned mainly with the deduction in respect of inter-corporate dividend, the Court in the course of its judgement has specifically referred to some of the other Sections contained in Chapter VIA of the Income tax Act and observed that on a plain reading of the Sections, the deduction is admissible in respect of the gross amount of income received by an assessee and not in respect of the net income computed after making the deductions provided in the Income-tax Act. In order to remove any possible doubt in this matter, a new Section 80AB has been inserted in the Income-tax Act to provide that for the purpose of calculation of the deduction specified in Sections 80HH to 80TT, the net income computed in accordance with the provisions of Income-tax Act (before making any deductions under Chapter VIA) shall alone be regarded as income received by the assessee and which is included in his gross total income. Accordingly, the deductions specified in the aforesaid Sections will be calculated with reference to the net income as computed in accordance with the provisions of the Act (before making deductions under Chapter VIA) and not with reference to the *gross* amount of such income subject, however, to the requirements of the respective Sections.

The new Section 80AB is effective from lst April 1980 and will accordingly apply in relation to the assessment year 1981-82 and subsequent years. It is to be noted that unlike Section 80AA, the provisions of Section 80AB will not have any retrospective operation.

There are certain definitions given in section 80B. Accordingly "gross total income" for the purposes of Chapter VI-A means the total income computed in accordance with the provisions of the Act without making any deduction under Chapter VI-A and/or under section 280-0. "Computed in accordance with the provisions of the Act" implies—

(1) that deductions under appropriate computation sections have already been given effect to,

(2) that income of other persons, if includible under sections 60 to 64 has been included.

(3 that intra-head and/or inter-head losses have been adjusted and

(4) that unabsorbed business losses etc. unabsorbed depreciation, unabsorbed investment allowance etc. have been set off.

The deductions allowable under Chapter VIA can be classified into two categories.

1. *Deductions in respect of Payments.*

   8(C, 80CC, 80D, 80E, 80F, 80G, 80GG, 80GGA, 80V, 80VV

2. *Deductions in respect of Incomes.*

   80HH, 80HHA, 80HHB, 80HHC 80I, 80J, 80JJ, 80K, 80L, 80M, 80MM, 80N, 80O-, 80P, 80QQ, 80QQA, 80R, 80RR, 80RRA, 80S, 80T, 80TT, 80U.

A further classification can also be made on the basis of their applicability as follows :

I. Deductions applicable to Individuals only

Sections 80E, 80F, 80GG. 80QQA, 80R, 80RR, 80RRA, 80U.

II. Deductions applicable to Individuals and HUFs

Section 80D.

III. Deductions applicable to Individual, Hindu Undivided Families and specified association of persons

Sections 80C, 80CC, 80L.

IV. Deductions applicable to all non-corporate assessee

Sections 80-S, 80-T, 80TT.

V. Deductions applicable only to Corporate assessees

Sections 80M (Domestic Company), 80MM (Indian Company), 80N (Indian Company), 80-O (Indian Company).

VI. Deductions applicable to all assessees

Sections 80G, 80GGA, 80HH, 80HHA, 80I, 80J, 80JJ, 80JJA, 80K 80QQ, 80V, 80VV.

VII. Deductions applicable to Indian Companies and other resident non-corporate assessees

Sections 80HHB, 80HHC.

VIII. Deduction applicable to co-operative societies

Section 80P.

Let us first consider the deductions allowable in respect of certain payments.

1. Life Insurance Premia, contribution to provident funds etc. (Section 80C)

The classes of assessees to whom the provisions of section 80C apply are—

(i) individuals

(ii) Hindu undivided families

(iii) association of persons in certain Union Territories such associations consisting of husband and wife.

The scheme of section 80C is that if the assessee pay any life insurance premium etc. during the previous year *out of his income chargeable to tax*, he becomes entitled to a deduction from his gross total income of an amount equal to the aggregate of :

For Assessment years 1981-82 and 1982-83

100% of the first Rs. 5,000 — of the qualifying amount

50% of the next Rs. 5,000

40% of the remainder

For Assessment year 1983-84 (Amendment made by Finance Act, 1982 (14 of 1982 .

100% of the first Rs. 6,000 — of the qualifying amount

50% of the next Rs. 6,000

40% of the remainder

In order to get the benefit, the sums must have been paid (1) by the assessee. (2) out of his income chargeable to tax. Coming to the question of payments being made out of incomes chargeable to tax, there is no difficulty so far as deductions at source are concerned. But in other cases the assessee has to demonstrate that such payments flowed out of his chargeable income. Thus, if a non-resident person pays life insurance premium out of his foreign income net includible in his total income no deduction will be available to him in respect of such premium.

In C.I.V. Chellaiah 147 I.T.R. 590 (Madras) the interest earned by the assessee's wife on the amounts gifted by the assessee was included in the total income of the assessee by virtue of section 64(1)(iv). Premia in respect of the policy of his wife was paid out of her interest income. The question arose as to whether the premium so paid would be deductible under section 80C in computing the income of assessee. It was held that even though the interest income earned by the assessee's wife was included in the assessee's total income as per section 64(1)(v), it was to be treated as gross total income of the assessee as contemplated under section 80A(1). Hence, the assessee would be entitled to relief under section 80C in respect of the premium paid on the policy taken out of interest earned by his wife.

The various items of payment in respect of which a deduction is allowable under this section are stated below :

A. In the case of individual

(1) Premium paid on insurance on the life of the assessee and/or his or her spouse or child (minor or major).

(2) Premiums paid to effect or keep in force a contract for a deferred annuity on the life of the assessee and/or of his or her spouse or child, provided such contract does not contain any provision for the exercise by the insured of an option to receive a cash payment in lieu of the payment of the annuity.

In the above two cases the qualifying amount of premium in respect of any particular policy shall not exceed 10% of the actual capital sum assured. However, if the premium paid is in excess of 10% of the capital sum assured, the amount of premium paid in excess of 10% shall not qualify for the deduction. For this purpose while calculating the capital sum assured no account shall be taken of the value of any premium returnable or any benefit by way of bonus receivable by the insured over and above the capital sum assured on the policy.

It is pertinent to note here that a contract for a deferred annuity need not necessarily be with an insurance company. It follows therefore that such a contract can be earned into with any person.

In the case of an individual the insurance on his life will include a policy of insurance securing the payment of a specified sum on the stipulated date of maturity if such person is alive on such date, even if the policy provides only for the return of premiums paid with or without interest thereon in the event of his dying before the said stipulated date. The insurance shall also include a policy effected by a person for the benefit of a minor, with the object of enabling such minor after he has attained majority, to secure an insurance on his own life by adopting the policy and on his being alive on a date after the adoption, specified in the policy in this behalf.

C.B.D.T. Circulars : (a) The relief under section 80C is available to contributions made under the Central Government employee's Insurance Scheme (Circular No. 233 dated 5.12.77).

(b) The contributions made by employees to the Family Pension Fund established by a scheme under the Employees Provident Fund and Family Pension Fund Act, 1952 would also qualify for deduction under section 80(c) (2) (a) (ii). (Circular No. 194 dated 25th March 1976).

(3) Contributions to any Provident Fund to which Provident Fund Act, 1925 applies. In this case the entire amount contributed by the assessee shall qualify for deduction subject to the over-all limit.

(4) Contributions made to any provident fund set up by the Central government and notified in this behalf (i.e. the Public Provident Fund Act, 1968).

(5) Contribution to a recognised provident fund of which he is a member. The excess, if any, over 1/5th of the salary or over Rs. 10,000 whichever is less is to b ignored. 'Salary' here includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. It may be noted here that the limitations of one-fifth of salary or Rs. 10,000 as the case may be, do not apply to contributions to a Provident Fund to which the P.F. Act, 1925 applies.

(6) Amount deducted by or on behalf of the Government, from the salary of a Government employee for securing a deferred annuity or making provisions for his wife or children. The excess, if any, over one-fifth of the salary is to be ignored. The overall limit applies.

(7) Assessee's own contribution to an approved superannuation fund of which he is a member. The entire contribution subject to the over-all limit, qualifies for the deduction.

(8) Deposits in a 10 year or 15 year account under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959. Subject to the over-all limit the entire amount deposited qualifies for the deduction.

(9) Contributions for participation in the Unit-linked Insurance Plan, 1971. The entire amount subject to the over-all limit, qualifies for the deduction. However, section 80C(5) provides that if an assessee terminates his participation before the

contributions in respect of the participation have been paid for 5 years, then no deduction is to be allowed for the contributions for the year of termination and moreover, the deductions, if any, allowed for the preceding previous year shall be deemed to be income of the year of termination and charged to tax accordingly.

2. In the case of Hindu Undivided Families :

There is only one item here viz. the sum paid to effect or keep in force an insurance on the life of any member of the family. Here also the limitation of 10% of the capital sum assured applies. As already noted in the case of an individual, the amount qualifying for deduction would include also the premium on the policy of a minor (male or female) of the family with the object of enabling the minor, on his/her attaining majority, to secure an insurance on his own life by adopting the policy.

Amendment by the Finance Act 1983 : The Finance Act 1983, has provided that with effect from 1.4.84 (assessment year 1984-85). H.U.Fs would be entitled to deduction under this provision, in respect of the following categories of long-term savings also.

(i) Contribution to a public provident fund in an account standing in the name of any member of the family.

(ii) Deposits made in a 10 year of 15 year account standing in the name of any member of the family under the Post Office Savings Bank (Cumulative Time Deposits) Rules 1959.

3. In the cases of certain association of persons :

The benefit described above is available also to an assessee being an association of persons or a body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union Territories of Dadra and Nagar Haveli and Goa, Daman and Diu.

The items for which the benefit is available, overall limits etc. are the same as in the case of individuals described above.

Policy Terminated before 2 years premiums paid : [80 (c) (b)] Where an individual, Hindu Undivided family or married couple governed by the system of community of property in specified Union Territories has effected or kept in force any insurance on the life of the specified persons and such assessee terminates the contract of insurance by notice to this effect or where the contract ceases to be in force as a result of failure to pay any premium by not reviving the contract of insurance before premiums have been paid for a period of two years, no deduction under section 80C shall be allowed to the assessee in respect of such premiums paid in the previous year in which the policy is terminated. Further any deduction allowed in respect of premium or premiums paid in the immediately preceding previous year or years shall be deemed to be the income of the assessee of such previous year or years and shall be charged to tax accordingly.

Explanation 1 to section 80C(b) provides that the deduction allowed under section 80C in respect of any premiums paid in any previous year shall be the amount by which the actual deduction allowed under that section for that year exceeds the amount of deduction which would have been allowed for that year if no such premiums had been so paid.

Explanation 2 to section 80C(b) provides that where an assessee terminates his participation in the unit linked insurance plan and also a contract of insurance in the same previous year, the deduction allowed under section 80C in respect of such contribution or premiums paid for the previous year shall be the amount which the deduction allowed under section 80 for that year exceeds the amount of deduction which would have been allowed for that year if no contributions of premium had been paid during the year.

The Finance Act, 1982, has also empowered the CBDT, under Section 80C (2) (h), to notify any security, the subscription to which by *all the above three categories of assessee* will qualify for deduction. In exercise of this power, the CBDT has notified National Savings Certificates VI and VII issues for this purpose.

Overall limits ; The aggregate of the sums which qualifies for the purposes of computing the deduction shall not exceed the following limits :

(i) For an individual who is an author, playwright, artist, musician, actor or sportsman including an athlete the CBDT has prescribed the maximum overall limits in Rule 11A The qualifying amount by reference to which the deduction is to be computed, shall not exceed the lower of the following two amounts—

(i) an amount equal to the aggregate of 40% of the income from such profession included in his gross total income and 30% of the remaining part of the gross total income or

(ii) a sum of Rs. 60,000 whichever is less.

2. For any other individual to whom paragraph (a) does not apply, a HUF or an association of persons as mentioned above, the overall limit is 30% of the gross total income subject to the maximum of

Rs. 30,000 upto 1982-83 assessment year.

Rs. 40,000 from 1983-84 assessment year.

Amendments by Finance Act, 1983 : The Finance Act, 1983 has abolished the ceiling by way of percentage of the gross total income, while determining the qualifying amount of savings, with effect from 1st April 1984 (Assessment year 1984-85). Consequently the qualifying amount would be subject to only monetary ceilings viz Rs. 60,000 or Rs. 40,000 as the case may be.

2. **Deduction in respect of investment in certain new shares** : (80CC) Section 80CC has been inserted with a view to give some inducement to tax-payers so that they may acquire shares in new industrial companies. The benefit is by way of a deduction from the gross total income of a sum equal to 50% of the cost acquisition of the shares forming part of the eligible issue of capital. The benefit is available to assessees of the following categories :

(a) individuals

(b) Hindu Undivided Families

(c) association of persons or a body of individuals consisting only of husband and wife governed by the system of community of property in force in the Union territories of Dadar and Nager Haveli and Goa, Daman and Diu.

Conditions : 1. The assessee must acquire the equity shares forming part of an eligible issue of capital during the previous year out of his income **chargeable to tax.**

2. The maximum amount of investment qualifying for the deduction is Rs. 20,000.

3. Where the full payment of the money required for the investment has not been made in the previous year in which the acquisition takes place, but the unpaid portion is paid within the six months' period immediately succeeding the said previous year, the amount so paid will also be treated as paid in that earlier previous year itself.

4. Where the aggregate cost to the assessee of the shares acquired as above exceeds Rs. 20,000 the deduction will be allowed with reference to such of those shares the aggregate cost whereof to the assessee does not exceed Rs. 20,000 as are specified by him in this behalf.

5. The assessee should have subscribed to the shares in pursuance of an offer for subscription to the public made by the company or in pursuance of a reservation or an option made in his favour by reason of his being a promoter of the company.

6. Alternative to the above, the assessee should have purchased the shares from a person who is specified as an underwriter in respect of the issue of such shares, in pursuance of the relevant provisions of the companies Act and who has acquired such shares by virtue of his obligation as the under-writer for the issue.

7. Where an assessee has obtained the deduction in respect of any shares under section 80CC he loses that benefit if he disposes of those shares at any time within five years from the date of their acquisition. An amount equal to 50 per cent of the cost to the assessee of the shares so sold must be deemed to be the income of the assessee in respect of the previous year in which the shares were sold. Suchincome would have the character of income from other sources. For this purpose an assessee shall be regarded as having acquired any shares on the date on which his name is entered in relation to those shares in the register of members of the company.

Eligible issue of capital

For this purpose the expression "eligible issue of capital" means issue of equity shares which satisfies the following conditions—

(i) The issue is made by a public company formed and registered in India with the main object of carrying on the business of (a) construction, manufacture or production of any article or thing other than an article listed in the Eleventh Schedule to the Income-tax Act or (b) providing long-term finance for construction or purchase of houses in India for residential purposes.

(ii) The issue is an issue of capital made by the company for the first time.

(iii) The shares forming part of the issue are offered for subscription to the public.

(iv) Such other conditions as may be prescribed by the Central Board of Direct Taxes should also be fulfilled.

In the case of a public company formed and registered in India, with the main object of carrying on the business of providing long-term finance for construction

or purchase of house in India for residential purposes, in order to entitle the investor shareholder to claim the tax benefit under this Section it is also essential that the company must be approved by the Central Government for this purpose

In cases where a company was originally incorporated as a private company but it has subsequently become a public company under the provisions of the Companies Act, an issue of shares made by it for the first time after it has become a public company would not be regarded as an eligible issue of capital if (i) such company had declared, distributed or paid any dividend when it was a private company ; or (ii) any of the shares forming part of the issue is offered for subscription at a premium Wherever any question arises as to whether any issue of equity shares would constitute an eligible issue of capital for purposes of this deduction the question should be referred to the Central Government whose decision thereon shall be final. In this context, the expression 'company' must be taken to have the same meaning as is assigned to it under Section 3 of the Companies Act, 1956.

By virtue of an amendment made by the Finance Act 1984 no deduction will be available with reference to the cost of any shares offered for public subscription after 31.3.1987.

Expenditure on medical treatment of handicapped dependents (80D)

The Finance Act, 1981 has liberalised the scope of this provision.

(1) Individual and Hindu Undivided families resident in India.

(2) Incurring any expenditure on the medical treatment (including nursing) of a 'handicapped dependent'.

(3) Out of their income chargeable to tax deduction are entitled to a specified.

Handicapped dependent :

In the case of an individual any one of his relatives as defined in section 80B(8) and, in the case of a Hindu undivided family any member of the family, who is exclusively dependent on the individual or family as the case may be for his support and maintenance and who is suffering from a physical or mental disability which is certified by a medical practitioner to have the effect of reducing considerably such person's capacity for normal work or engaging in a gainful employment.

Limit of deduction :

(1) If the handicapped dependent has been treated for 182 days or more during the previous year in an approved institution—being a hospital or nursing home or other institution—a sum of Rs. 4800 will be allowed as a deduction from the gross total income.

(2) In any other case—a sum of Rs. 1200 will be allowed as deduction.

Students may note that the actual amount of expenditure incurred may be even less than the specified deduction.

By virtue of an amendment made by the Finance Act, 1984 the deduction under section 80D will not be available for the assessment year 1985-86 and onwards.

Deduction in respect of Payments for Securing Retirement Annuities : (80E)

The benefit of this deduction is available only to individual who are citizens of India and residents in India and are partners in a registered firm rendering professional service as chartered accountants, solicitors, lawyers, architects or experts in other approved professional services. The deduction is allowable in respect of :

(a) any premium paid under an approved annuity contract with the main object of providing for a life annuity for the individual commencing between the ages 58 and 68 or for the individual's widow or widower; or

(b) any premium paid to an approved annuity fund. The premium so paid is to be deducted from the assessee's gross total income but the allowance shall not exceed the income arising under the head 'profits and gains of business or profession'. Further, the amount of deduction shall not exceed Rs. 5,000 or 10% of the gross total income or the amount of premium actually paid, whichever is the least.

But if the assessee has a total income which includes unearned income exceeding Rs. 10,000 or is entitled to any pension or participates in any pension or superannuation fund, he cannot claim this deduction. 'Unearned income' here means income chargeable under the head 'Interest on securities' or Income from house property' or 'Capital gains' or any income chargeable under the head 'Income from other sources' in so far as it is not immediately derived from personal exertion of the individual. The section also specifies the conditions that must be satisfied, before the contract of annuity and annuity fund can be approved by the commissioner

Further, if the individual himself is the recipient of the annuity it is deemed to be his earned income, to the extent to which it is attributable to the deduction allowed under this Section. But it any other person receives the annuity, it is to be treated as his unearned income to the extent to which it is attributable to the amount deductible under this Section. The person responsible for paying the annuity is required to deduct tax at the appropriate rates from the amount of annuity payable.

By virtue of an amendment made by the Finance Act 1984 no deduction will be allowed under the provision in relation to the amount paid after 29.2.1984.

Deduction in respect of educational expenses in certain cases. (80F)

The deduction under this Section is available only if all the following conditions are satisfied.

(a) The assessee must be a resident individual and must not be a citizen of India.

(b) During the relevant previous year he should have incurred the expenditure out of his income chargeable to tax in India for the full time education of his child.

(c) The child should be wholly or mainly dependent on him.

(d) The child should be not more than 21 years of age.

(e) The education of the child should be at any University, college or other educational institution situated outside India.

The amount of deduction to which the individual is entitled is :—

(i) Rs. 1,500 if there is only one such child;

(ii) 3,000 if there is more than one child studying abroad.

The deduction is allowable irrespective of the actual amount spent by the assessee.

Deduction in respect of donations to certain Funds, charitable Institutions etc. (80G)

Where an assessee pays any sums as donations then he is entitled to a deduction, subject to certain limitations, from the gross total income.

The following table gives the details of the institutions to which eligible donations can be made, the qualifying amount and the deductions allowable.

Donations paid to 1	Maximum limit of qualifying amount 2	Permissible deduction 3
1. The National Defence Fund set up by the Central Government.	If the aggregate of donated amounts in a previous year is less than Rs. 250/- the benefit of section 80G is not available.	50% of the qualifying amount.
2. The Jawaharlal Nehru Memorial Funds.	No maximum limit is there for items 1 to 5. The entire amount as such donations would qualify for deduction.	50% of the qualifying amount.
3. Prime Minister's Drought Relief Fund	For items 6 to 10 the aggregate of the sums qualifying for deduction will be limited to (1) 10% of the gross total income as reduced by any income on which no tax is payable and by any amount in respect of which the assessee is entitled to a deduction under Chapter VIA. OR (2) 5,00,000 whichever is less.	50% of the qualifying amount.
4. Prime Minister's National Relief Funds.		50% of the qualifying amount

1	2	3
5. National Children's Fund.		50% of the qualifying amount.
6. Institution or fund established in India fulfilling certain prescribed conditions.		50% of the qualifying amount.
7. Government or any local authority for utilisation for any charitable purpose other than the purpose of promoting family planning.		50% of the qualifying amount.
8. Statutory bodies (like Housing Boards) established or satisfying needs for housing accommodation, town planning etc. the income of which qualifies for total exemption from tax under section 10 (20A).		50% of the qualifying amount.
9. Government or any approved local authority, institution or association for promotion of family planning.		100% of the qualifying amount.
10. Notified temple, mosque, gurdwara, church or other place of historic, archaeological or artistic importance or which is a place of public worship of renown throughout any state or states.		50% of the qualifying amount.

The conditions mentioned in item No. 6 above are as follows :

1. The institution or fund is

   (a) constituted as a public charitable trust or

(b) registered under the Societies Registration Act, 1960 or under any corresponding law or under section 25 of the Companies Act, 1956 or

(c) is a University or

(d) is an institution approved by the Central Government for the purposes of section 10 (23) or

(e) is an institution financed wholly or in part by the Government or a local authority.

2. Where such institution or fund derives any income, such income should not be liable to inclusion in its total income under the provisions of section 10 (22), 10 (22A), 10 (23), 10 (23C), or 11 or 12.

However, it may be noted that the assessee will not lose the benefit of deduction if :

(a) subsequent to the donation any part of the income of the institution has become chargeable to tax due to non-compliance with any of the provisions of section 11 or 12 or 12A.

(b) as a result of the operation of section 14(1)(c), exemption under section 11 or 12 is denied to the institution.

3. No part of the income or assets of the institution or fund is transferable or applicable at any time for any purposes other than charitable purpose. Such charitable purpose however does not include any purpose the whole or substantially the whole of which is of a religious nature.

4. The institution or fund is not expressed to be for the benefit of any particular religious community or caste. An institution or fund established for the benefit of women and children or of Schedule Caste. Backward classes or Scheduled Tribes is not however to be treated as an institution or fund for the benefit of a religious community or caste.

In this connection students may note that donations to item No. 10 are admissible even though those places are for the benefit of a particular religious community.

5. The institution or fund maintains regular accounts of its receipt and expenditure.

Limits with reference to aggregate donations

Section 80G (4) substituted with effect from 1-4-81 clarifies that the limits prescribed therein will apply with reference to the aggregate amount of donations qualifying for deduction and not with reference to the quantum of deduction admissible. The limits are indicated in column 2 of the Table above.

No double deduction : Where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not qualify for deduction under any other provision of the I.T. Act for the same or any other assessment year.

Donations in kind : Explanation 5 to section 80G(5A) provides that donations in kind shall not qualify for deduction.

Nexus with assessees business : The deduction under section 80G can be claimed whether it has any nexus with the business of the assessee or not.

Deduction in respect of rents paid : (80GG)

This benefit is available with effect from the assessment year 1976-77. An employee who does not receive a cash house rent allowance, from an employer in respect of which a total exemption from liability to tax is admissible under section 10(13A) read with Rule 2A or any other assessee who is a self-employed person is entitled to the benefit if certain other conditions are fulfilled.

1. He must incur some expenditure towards payment of rent in respect of any furnished or unfurnished accommodation occupied by him for the purposes of his own residence. Thus, if a person resides in his own house, he is not entitled to the benefit.
2. The assessee must be paying a rent in excess of 10% of his total income. Here total income means the assessee's total income after allowing all deductions except the one provided under section 80GG itself.
3. The assessee or his spouse or minor child or the Hindu Undivided family of which he may be a member, must not be the owner of any residential accommodation whatsoever.

Amendment by Finance Act, 1983

The Finance Act 1983, has made an amendment in Section 80GG, effective from assessment year 1984-85, to provide that deduction in respect of rents paid will be denied only (1) where the assessee owns any residential accommodation at the place where he ordinarily resides or performs duties of his office of employment or carries on his business or profession and (2) where the residential accommodation owned by him is at any other place if it is occupied by him for the purposes of his own residence.

4. Rule 11B stipulates that the accommodation for which the rent is paid and the benefit is claimed must be one situated in any one of the following places namely—Agra, Ahmedabad, Allahabad, Amritsar, Bangalore, Bombay, Calcutta, Cochin, Coimbatore, Delhi, Hyderabad, Indore, Jabalpur, Jaipur, Kanpur, Lucknow, Madras, Madurai, Nagpur, Patna, Pune, Sholapur, Srinagar, Surat, Trivandrum, Vadodara, Varanasi.

Quantum of benefit : 1. Excess of rent actually paid over 10% of the total income.

2. 15% of total income.

3. Rs. 400 per month whichever is the least.

Deduction in respect of donations for scientific research and rural development : (80GGA)

Section 80GGA grants deduction in respect of the donations made for scientific research and rural development by *any taxpayer* out of the income, included in the gross total income. The whole of the amount of donation would qualify for deduction under this provision as compared to 50 per cent of the qualifying

amount of donation being allowed as a deduction under Section 80G of the Income-tax Act. The amounts qualifying for deduction are :

(i) any sum paid by the assessee in the previous year to a scientific research association which has, as its object, the undertaking of scientific research, or to a University, college or other institution to be used for scientific research : and

(ii) any sum paid by the assessee in the previous year to an association or institution which has as its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority for purposes of Section 35CCA or to an institution or association which has as its object, the training of persons for implementing programmes of rural development.

It is, however, essential that in respect of both the aforesaid donations, the association or institution to which the donation is given must be approved by the prescribed authority ; in the case of donations for scientific research, the donation must be to the institution approved under Section 35(1) (ii) whereas in the case of donation for rural development the institution or association must be approved by the prescribed authority under section 35CCA(2) of the Income-tax Act.

The benefit of deduction under Section 80GGA would not, however, be admissible in the case of those taxpayers whose total income includes income which is chargeable to tax under the head 'profits and gains of business or profession' since, in the case of those taxpayers the amount of donation would be allowed as a deduction under Section 35 or 35CCA whichever is applicable. Wherever the assessee is entitled to claim the deduction under the new Section 80GGA in respect of any donation, no deduction shall be allowed to the sae assessee for the same or for any other assessment year in respect thereof.

Under clause (c) in section 80GGA (2) any sum paid by an assessee (who is not deriving any income under the head 'profits and gains of business or profession) to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources, to be used for carrying out any programme approved under Section 35CCB is also to qualify for and from assessment year 1983-84 for deduction in the computation of his taxable income. It may be noted that deduction in respect of such payment under the head 'Profits and Gains of business or profession' is available under section 35CCB itself.

Amendments by Finance Act, 1983 : 1. The deduction in respect of sums paid to any association or institution for carrying out any programme of rural development or for training of persons for implementing such programmes will be allowed only if the assessee produces a certificate from such association or institution on referred to in sub-section (2) or such section (2A) of section 35CCA.

2. Under the new clause (d) deduction will be allowed in respect of any sum paid by an assessee to any rural development fund that may be set up and notified by the Central Government for the purpose of section 35CCA(1)(C).

Deduction of interest on moneys borrowed to pay taxes. (80 V)

Since 80V allows a deduction from the gross total income of all taxpayers, whether corporate or non-corporate, of a sum equal to the amount of interest, if any, paid by them during the previous year or any money borrowed for the purposes of payment of any tax due from them under the Income tax Act. In order to be allowable as a deduction, the assessee should, however, prove that the amount of interest is actually paid during the accounting year ; it is not enough if the interest is merely payable. The allowability of this deduction presupposes that the assessee had borrowed the money specifically for payment of tax. If the borrowing is not specifically for this purpose, the interest payable thereon would not be allowable as a deduction under this section. Prior to the insertion of this Section, interest on moneys borrowed for payment of income-tax, which is a personal liability of the taxpayer, was not allowable as a deduction in computing the business income or income from any other source of the taxpayers [Kameswar Singh v. C.I.T. (1961) 41 I.T.R. 774]. There, is, however, no monetary limit in regard to the amount of borrowing, the rate of interest payable or the amount admissible as deduction.

Deduction in respect of expenses incurred in connection with income tax proceedings (80VV)

Section 80VV provides that in computing the total income of an assessee, a deduction shall be allowed in respect of expenses actually incurred by him during the relevant accounting year in respect of any proceedings before any income-tax Authority, the Appellate Tribunal or any court relating to the determination of any liability to tax under the Income-tax Act, including the liability to penalty or interest. This deduction is, however restricted to the amount of Rs. 5,000 for each assessment year. In other words, the deduction allowable to the assessee in respect of expenses incurred for Income-tax proceedings would be either the amount of actual expenses incurred by the assessee or Rs. 5,000 whichever is less. Prior to the insertion of this provision expenses in the matter of litigation or other normal proceedings relating to the Income-tax assessment were treated as part of legal expenses and they were allowable in full and without any limits, as an item of business expenses under Section 37(1) of the I.T. Act ; in the case of other tax payers the deduction was not allowable since the provisions relating to the computation of income under the other heads do not contain any specific provision for the allowance of such expenses or a general provision wherein the deduction could be claimed. Now this deduction is available to corporate as well as non-corporate taxpayers.

Deductions in respect of certain incomes :

Deduction in respect of profits and gains from newly established industrial undertakings or hotel business in backward areas : (80HH).

Under this section an assessee will be entitled to the benefit of deduction from gross total income of the sum equal to 20% of the profits and gains derived by him from a new industrial undertaking or the business of a hotel which is established and carried on in any backward area. The benefit, however, is not admissible to an undertaking engaged in mining. The Act has not defined the expression 'Industrial undertaking'. The concept of industrial undertaking need not necessarily be confined to manufacture and production of articles. Thus, a contractor who had undertaken the construction of an irrigation project was held entitled to the benefit of section 80HH. The name of backward areas are given in the Eighth Schedule.

Conditions : This concession is available to any industrial undertaking which fulfills all the following conditions :

1. It began or begins to manufacture or produce articles after 31st December, 1970 in any backward area.

2. It is not formed by the splitting up or the reconstruction of business already in existence in any *backward area*. But the above restriction does not apply to the case of a reconstruction, reestablishment or revival referred to in Section 33B of the Act providing for the grant of a Rehabilitation Allowance.

3. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose in any backward area. However where the total value of the machinery or plant so transferred does not exceed 20% of the total value of the machinery or plant used in the business then the assessee will not be disqualified from claiming the deduction.

4. The undertaking must employ at least ten workers in a manufacturing process carried on with the aid of power or at least twenty workers in a manufacturing process carried on without the aid of power.

In the case of a hotel business, such business must have started or must start functioning after 31st December 1970 in any backward area and such a business should not have been formed by the splitting up or the reconstruction of a business already in existence (*in any area*). In addition, it must be approved for the time being by the Central Government. It is significant to note that under Section 80HH, hotel business carried on by any assessee [not necessarily by an Indian company, as in the case of Section 80I] would be eligible for the tax benefit, subject to the satisfaction of the specified conditions.

Period : The deduction of 20% is allowable from the assessee's gross total income in respect of the ten assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or the hotel starts functioning.

If the commencement is made after 31st March, 1973 the deduction will be for ten assessment years starting with the assessment year relative to such commencement. But if the commencement is made between January 1, 1971 and March 31, 1973 the ten years are to be reduced by the assessment years which expired before 1st April 1974. The following table will make the position clear.

Previous year	*Commencement*	*Relevant Asst. year*	*Benefit available for*
Calendar year	1971	1972-73	8 asst. years starting from 74-75.
Calendar year	1974	1975-76	10 asst. years starting from 75-76.

Audit : Where the assessee is other than a company or a cooperative society the deduction under this section will be admissible only if the accounts of the industrial undertaking or the business of the hotel for the previous year relevant to the assessment year in respect of which the deduction is claimed are audited by a chartered accountant or any other accountant as defined in the Explanation to Section 288(2) and the assessee furnishes along with the return of his income the report of such an audit in the prescribed form (No. 10C) duly signed and verified in the prescribed manner by the accountant concerned.

Transfer of goods at value other than the market value : For the purposes of determining the profits of the undertaking or the hotel, where any goods held, therefore, are transferred to any other business carried on by the assessee or vice versa, the value of the transfer, if not recorded at market rates, will have to be accounted for as at market rates. Thus, if the owner of the undertaking transfers the products of the undertaking to another business carried on by him at Rs. 3,00,000 while the market value thereof is Rs. 5,00,000 the book profits of the undertaking are to be increased by Rs. 2,00,000 to arrive at Section 80HH. On the other hand, if such transfer be at Rs. 6,00,000 the book profits have to be reduced by Rs. 1,00,000. Where, however, the computation of the profits in this manner creates exceptional difficulties, the ITO is entitled to resort to estimates.

Colourable transactions : If the assessee owning the undertaking has transaction with other persons with whom he has close connection and due to such close connection the affairs are so arranged as to produce more than normal profits to the undertaking, the ITO shall take account only of such normal profits in computing the benefit under section 80HH.

80HH deduction to have priority : In a case where the assessee is entitled also to the deduction under Section 80-I or Section 80J in relation to the profits and gains of an industrial undertaking or the business of hotel to which this section applies, effect shall first be given to the provisions of this section.

Deduction in respect of profits and gains derived from newly established small-scale industrial undertaking in rural areas : Section 80HHA grants exemption from income-tax by way of deduction from gross total income to taxpayers deriving income from the business of a new industrial undertaking established in a *rural area* as defined in Explanation (b) to Section 35CC(1). This exemption is available to all taxpayers, both corporate and non-corporate, but the industrial undertaking, the profit from which qualifies for deduction, should be *small scale industrial undertaking*. For this purpose, an industrial undertaking would be deemed to be small scale industrial undertaking if the aggregate value of machinery and plant (other than tools, jigs, dies and moulds) installed as on the last day the accounting year for the purpose of the business of the industrial undertaking does not exceed Rs. 1,00,000.

Amendments made by the Finance Act, 1981

As a result of the amendments made by the Finance Act, 1981, in Section 80HHA, in cases where the previous year ends after 31st July, 1980, the limit in respect of aggregate value of machinery or plant installed as on the last date of the relevant previous year would be Rs. 20 lakhs. Further, the benefit of tax concession

under Section 80HHA has been extended to industrial undertakings which did not qualify for the same before that date on the ground that the aggregate value of machinery or plant installed therein exceeded Rs. 10 lakhs but did not exceed Rs. 20,00,000. In such cases, the concession will be available for the unexpired period.

(i) In the case of any machinery or plant owned by the assessee, the value thereof should be taken to be its actual cost to the assessee as defined in Section 43(1).

(ii) In the case of any machinery or plant hired by the assessee, its actual cost, which would have been taken in the case of the owner of such machinery or plant would be regarded as the value of the machinery or or plant to the assessee.

The admissibility of this deduction pre-supposes that profits and gains are derived from the new industrial undertaking and such profits are included in the gross total income of assessee for the relevant assessment year commencing from 1st April, 1978 or any subsequent year. The amount of deduction is a sum equal to 20 per cent of the profits and gains derived by the assessee during the previous year and included in the gross total income.

The allowance of this deduction is also subject to the further condition that the small-scale industrial undertaking which has been newly established, begins to manufacture or produce articles at any time on or after 1st October, 1977 in any rural area and it is not formed by the splitting up or the reconstruction of a business already in existence. However, the condition in regard to the splitting up or reconstruction of a business already in existence being taken as the basis for the formation of a new industrial undertaking would not apply in respect of any small-scale industrial undertaking which is formed as as a result of the re-establishment, re-construction or revival by the assessee of the business of any such industrial undertaking which is discontinued, damaged or destroyed, as a result of the factors beyond the assessee's control entitling the assessee to the benefit of rehabilitation allowance under Section 33B of the Income-tax Act in those circumstances and within the time-limit of three years specified in that Section.

The new industrial undertaking should not have been formed by the transfer to the new business of machinery or plant previously used for any purpose. However, in cases where any machinery or plant or any part thereof previously used for any purpose is transferred does not exceed 20 per cent of the total value of the machinery or plant used in the business of the new industrial undertaking, then the assessee would be deemed to have complied with the condition. Accordingly, in such cases there would be no question of denial of the benefit of deduction admissible to the assessee under a new Section 80HHA. Another important condition which should be fulfilled by the new units is that it should employ 10 or more workers in a manufacturing process carried on with the aid of power or 20 or more workers in a manufacturing process carried on without the aid of power.

This deduction is available to taxpayers for a period of *ten* consecutive assessment year beginning with the assessment year relevant to the accounting year in which the small-scale industrial undertaking begins to manufacture or produce articles or things. The amount of deduction is dependent upon the quantum of profits

derived from the new industrial undertaking and the amount thereof remaining in the hands of the assessee after the set off of losses, depreciation allowance, investment allowance, etc.

In cases where the new industrial undertaking is one in respect of the profits of which the tax-holiday benefit is also to be granted to the assessee under Section 80I, the benefit of deduction under Section 80HHA would be first allowed and only in respect of the balance of the profits remaining in the hands of the assessee, the question of deduction under Section 80J would arise.

Where the new industrial undertaking is one in respect of the profits of which the deduction under Section 80HH is admissible by virtue of the new industrial undertaking being established in backward area the assessee would not, in respect of the same industrial undertaking, be entitled to the deduction under Section 80HHA also. Similarly, when the new industrial undertaking is established in a rural area and the provisions of Section 80HHA are applicable to the assessee, the provisions of Section 80HH would not also apply to grant deduction in respect of the same profits. In other words, the assessee would not be eligible for deduction in respect of the profits from the same industrial undertaking under Section 80HH as well as Section 80HHA.

The provisions relating to audits for the specific purpose of getting the deduction applicable to non-corporate taxpayers under Section 80HH (5) would also be applicable to taxpayers, other than companies and co-operative societies for allowance of this deduction under Section 80HHA. The Audit Report should be in the prescribed form (Form No. 10CC) duly signed and verified by the auditor containing such particulars, as are required for the purpose; the Audit Report should be enclosed with the return of the assessee for each of the relevant assessment year for which benefit of deduction is admissible. The form of Audit Report has been prescribed under Rule 18BB.

The provisions of Section 80HH(6) and (7) for the purpose of substituting the fair market value of the goods transferred by the assessee from or to the new industrial undertaking for the consideration recorded in the accounts of the business and for the purpose of arriving at reasonable profits made from the business in the place of profits as per books would also apply in the case of industries established in rural areas for the purpose of computation of the profits on which deduction is allowable in the same manner and to the same extent as they would apply under Section 80HH(6) and (7) in the case of industries located in backward areas.

Any small-scale industrial undertaking which is engaged in the business of mining is not entitled to the deduction under the new Section 80HHA.

Deduction in respect of profits and gains from projects outside India: 80HHB.

The Finance Act, 1982 has inserted a new section 80HHB with effect from 1.4.1983. This new section provides for deduction in respect of profits and gains from projects outside India and this is meant to encourage contractors to undertake construction and engineering contracts outside India.

Eligible assessees : This relief is available from the assessment year 1983-84 to Indian companies and non-company assessees who are residents in India in respect of eligible profits and gains.

Eligible Profits and Gains : The profits and gains which are eligible for tax relief under section 80HHB are those derived from the business of—

(i) the execution of a foreign project undertaken by the assessee in pursuance of a contract entered into by him.

(ii) the execution of any work undertaken by the assessee and forming part of a "foreign project" undertaken by any other person in pursuance of a contract entered into by such other person.

The above contract should be entered into with the Government of a foreign State or any statutory or other public authority or agency in a foreign state or a foreign enterprise, and the consideration for such work should be payable in convertible foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purpose of FERA, 1978.

Foreign project means a project for—

(i) the construction of any building, road, dam, bridge or other structure outside India.

(ii) the assembly or installation of any machinery or plant outside India ;

(iii) the execution of such other work (of whatever nature) as may be prescribed.

Conditions : The deduction can be allowed only if the following conditions are satisfied :

(1) separate accounts should be maintained by the assessee in respect of eligible profits and gains. For assessees other than companies and co-operative societies audit is compulsory and such audit report should be attrached to the return of income.

(2) An amount equal to 25% of the eligible profits and gains should be debited to the profit and loss account of the previous year in which the deduction under this section is to be allowed and credited to a "Foreign Projects Reserve" Account to be utilized by the assessee during a period of five years for the purposes of the business other than for distribution by way of dividends or profits.

(3) An amount equal to 25% of the eligible profits and gains is brought by the assessee in 'convertible foreign exchange' into India within a period of six months from the end of the previous year or within such further period as may be allowed by the commissioner by an order in writing recording the reasons therefor.

Quantum of deduction : (1) 25% of the eligible profits and gains. (2) Where the amount credited to the Foreign Projects Reserve Account (FPRA) or the amount brought into India or either of these amounts is less than 25% of the eligible profits and gains, the deduction under this section is to be restricted to the

amount so credited to the *FPRA* or the amount actually brought by him into India, *whichever is less.*

Forfeiture on breach: Section 80HHB(4) provides that if, at any time before the expiry of five years from the end of the relevant previous year, the assessee utilises the amount credited to the FPRA for the purpose of distribution by way of dividends or by way of dividends or by way of profits or any other non-business purpose, the deduction which had been originally allowed to him under section 80HHB(1) is to be deemed to have been wrongly allowed. For this purpose the ITO has been empowered to recompute the total income of the assessee for the relevant assessment year and withdraw, by way of rectification, the tax benefit granted to the assessee. Such rectification order is to be made within a period of four years from the end of the previous year in which the amount was so utilised.

Ban on double deduction: Section 80HHB(5) enacts that no part of the consideration or of the income comprised in the consideration payable to the assessee for the execution of a foreign project or any other work shall qualify for deduction for any other assessment year under any such other provision (80 HH, 80HHA, 80I to 80TT).

Deduction in respect of Export Turnover (Section 80HHC) :

The Finance Act 1983 has inserted a new section 80HHC in the Income-tax Act relating to deduction in respect of export turnoevr w.e.f. 1.4.1983. Accordingly if a taxpayer being an Indian company or a person (other than a company) who is resident in India exports out of India during the previous year any goods or merchandise to which this section applies, he will be allowed the following deductions :

1. A deduction of an amount equal to one per cent of the export turnover of such goods or merchandise during the previous year, and

2. deduction of an amount equal to five per cent of the amount by which the export turnover of such goods or merchandise during the previous year exceeds the export turnover of the goods or merchandise during the immediately preceding previous year.

The new section applies to all goods or merchandise other than agricultural primary commodities, not being produce of plantations ; mineral oil ; minerals and ores and such other goods or merchandise as the Central Government may by notification in the official Gazette specify in this behalf. This concession will apply to sale proceeds of such goods or merchandise exported out of India as are receivable by the taxpayer in convertible foreign exchange.

This deduction will not be allowed unless taxpayer had, during the immediately preceding previous year exported out of India goods or merchandise to which this section applies.

Section 80 HHC will be effective from 1.4.1983 (83-84 assessment year).

Deduction in respect of profits and gains from industrial undertaking after a certain date etc : (80-I)

The benefit of tax holiday, for a new industrial undertaking, new cold storage plant, new hotel or new ship, which used to be available under section 80J, ceased

to be operative in respect of any undertaking, cold-storage plant, hotel or ship commencing operations after 31st May, 1981. The scheme of benefit under section 80 J has been replaced by a new scheme of tax-holiday, enacted in section 80-I by the Finance (No. 2) Act, 1980 effective from April 1, 1981.

80-I and 80J : In some respects the provisions of section 80-I and 80J are similar. There are, however, important differences also.

Similarities : Conditions to be fulfilled by industrial undertaking, ships and hotels to be eligible for the deduction are similar.

Differences : 1. Under section 80I deduction is allowed as a percentage of profits of the eligible undertaking, Under section 80J such deduction is allowed as a percentage of capital employed in the undertaking, hotel or ship.

2. Under 80 I there is no benefit of carrying forward any "deficiency" whereas 80J contains such a benefit.

3. 80J does not contain a provision like 80-I(6) the contents of which are explained in the following pages.

Nature of benefit under section 80-I

Section 80-I provides for a deduction from the profits of an eligible industrial undertaking, cold storage plant, hotel or ship of an amount equal to 25% of such profits where the assessee owning the undertaking, plant, hotel or ship is a company and 20% where the assessee is other than a company.

Duration of benefit : The benefit is to be allowed in eight consecutive assessment years, the first such assessment year being the assessment year relevant to the previous year in which

(i) in the case of an industrial undertaking it begins to manufacture or produce articles or things :

(ii) in the case of cold storage plant, it begins to operate.

(iii) in the case of a ship, it is first brought into use; and

(iv) in the case of a hotel, it starts functioning.

The first assessment year is termed in the Act as the "intitial assessment year".

For a cooperative society, the benefit is available for ten consecutive assessment years commencing with the initial assessment year.

Conditions to be fulfilled by the above entities :

1. **Industrial undertakings**

(a) It should not be formed by the splitting up, or the reconstruction of a business already in existence ; but this restriction does not apply in respect of an industrial undertaking to which the provision of section 33B applies.

(b) It should not be formed by the transfer to a new business of machinery or plant previously used for any purpose. If, however, the total value of such transferred machinery or plant does not exceed 20% of the total value of all the machinery or plant used in the undertaking the benefit under section 80-I will not be denied.

In certain cases even though the machinery or plant has been previously used, it would not be regarded as machinery or plant previously used for any purpose. The following conditions should be fulfilled for the above purpose.

(1) The plant or machinery had been used outside India.

(2) The user was a person other than ths assessee.

(3) Such machinery or plant had not at any time previous to the date of the installation by assessee, used in India.

(4) Such machinery or plant is imported into India from any country outside India.

(5) No deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.

(c) The undertaking manufactures or produces any article or thing, not being any articles or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India, and begins to manufacture or produce articles or things or to operate such plants or plants at any time within the period of four years next following March 31, 1981, or such further period as may be notified.

The above restriction regarding articles and things specified in the Eleventh Schedule does not, however apply to a small-scale industrial undertaking. A small-scale "industrial undertaking" in this context means an industrial undertaking the aggregate value of the machinery or plant (other than tools, jigs, dies and moulds) installed wherein, as on the last day of the previous year for the purposes of the business of the undertaking does not exceed Rs. 20 lakhs. The "value" for this purpose means the actual cost of the machinery or plant io the owner thereof where the assessee is the owner and in the case of any machinery or plant hired by the assessee the actual cost to the owner of such machinery.

(d) In a case where the industrial undertaking manufactures or produces articles or things, the undertaking employs ten or more workers in a manufacturing process carried on with the aid of power, or employs twenty or more workers in a manufacturing process carried on without the aid of power.

2. **Ships** : (a) The ship is owned by an Indian company and is wholly used for the purposes of business carried on by it.

(b) previous to the date of its acquisition by the Indian company, it was not owned or used in Indian territorial waters by a person resident in India.

(c) it is brought into use for the first time by the Indian company at any time within the period of four years next following April 1, 1981.

3. **Hotels :** (a) The business of the hotel is not formed by the splitting up, or the reconstruction, of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.

(b) the business of the hotel is owned and carried on by an Indian company with a paid-up capital of not less than Rs 5 lacs.

(c) the hotel is for the time being approved for the purposes of section 80-I by the Central Government.

(d) the business of the hotel starts functioning after 31st March 1981 but before April 1, 1985.

Industrial undertaking, Ship or Hotel to be treated as the only source of Income

In the case of *CIT v. Patiala Flour Mills Co. P. Ltd* (1978) 115 ITR 640 (SC) the Supreme Court negatived the contention of the revenue that before granting the benefit under section 80J, and loss, depreciation, or development-rebate arising in the unit should be carried forward and adjusted against the unit's profit for any subsequent assessment year *even though such loss, depreciation or development rebate had alreadv been fully absorbed by the assessable profits of the assessee from his other units in the prior year itself.*

Section 80-I(6) was enacted to over-rule this decision. It provides that for the purposes of determining the quantum of deduction under section 80-I for the initial assessment year and the subsequent assessment years, the industrial undertaking, ship or hotel is to be regarded as the only source of income.

This in effect would mean that the earlier years' losses and unabsorbed depreciation, etc. of that particular unit, *even if absorbed by profits from other sources, shall have to be carried forward notionally and adjusted from the current profits* of the new industrial unit, for the purposes of determining the quantum of relief available under Section 80-I.

The implication of the above provision is illustrated below :

Bharat Industrial Enterprises Private Limited is engaged in manufacturing activities. It has a manufacturing unit in Ahmedabad, engaged in the production of certain electronic products, since 1966 It established in February 1982 a new industrial unit manufacturing a new product, hitherto purchased by the company from outside market. The new unit started production on 15th April, 1982 and it satisfied all the conditions specified in Section 80I. During the previous year ending 31st December, 1982 the following details of the old and new units are available :

	Old unit	*New unit*
	Rs.	Rs.
Profits before depreciation and Investment allowance	25,00,000	50,000
Depreciation (including additional depreciation)	5,00,000	3,00,000
Investment Allowance	2,00,000	5,00,000

During the previous year ending 31st December, 1983, the particulars of the old and the new undertakings were as follows :

	Old unit Rs.	New unit Rs.
Profits before depreciation and Investment Allowance	30,00,000	20,00,000
Depreciation (including additional depreciation)	4,50,000	1,85,000
Investment Allowance	— —	37,500

The company wants to know whether it can claim deduction under Section 80I in respect of the units, for the assessment years 1983-84 and 1984-85 and if so the quantum of such benefit.

Bharat Industrial Enterprises Limited

Computation of Total Income for Assessment Year 1983-84

	Old unit Rs.	New unit Rs.
Profit before depreciation and Investment Allowance	25,00,000	50,000
Depreciation		
Old unit—	5,00,000	
	20,00,000	
New unit—Depreciation to be claimed against profits of new unit (out of a total of Rs. 3,00,000)		50,000
Depreciation of new unit claimed against profits of old unit (3,00,000 – 50,000)	2,50,000	
	17,50,000	
Investment Allowance— Old unit—2,00.000 New unit—5,00,000	7,00,000	
Gross Total Income/Total Income	10,50,000	

As the gross total income of the assessee does not include any profits and gains derived from the new industrial undertaking, no deduction under Section 80I could be claimed for the assessment year 1983-84. The income from the new unit computed in accordance with the provisions of this Act before making any deduction under Chapter VIA, is nil and consequently as per the provisions of Section

80AB, no income from the new unit shall be deemed to be included in the gross total income and consequently no deduction could be claimed under Section 80I.

The position for the assessment year 1984-85 will be as follows :

	Old unit Rs.	New unit Rs.
Profits before Depreciation & Investment Allowance	30,00,000	20,00,000
Depreciation—Old unit	4,50,000	
New unit		1,85,000
	25,50,000	18,15,000
Investment Allowance		37,500
	25,50,000	17,77,500
Gross Total Income		43,27,500
Less : Deduction under Section 80I		
Computation of Profits for the purposes of determining the quantum of deduction under Section 80I—[Section 80I(6)]		
Less : Profits—	17,77,500	
Depreciation & Investment Allowance of the new unit for the previous year ending 31-12-81, set off against the profits of old unit	7,50,000	
	10,27,500	
Deduction under Section 80I restricted to 25% of Rs 10,27,500		2,56,875
Total Income		40,70,625

Under the provisions of section 80I(6), for the purposes of determining the quantum of deduction under Section 80I, the profits and gains of the new industrial undertaking shall be computed as if such industrial undertaking were the only source of income of the assessee during the previous year relevant to the assessment year, for which the assessee is entitled to deduction under Section 80I. This specific provision supersedes the Supreme Court's decision in the case *C.I.T.* v. *Patiala Flour Mills. Co. (P) Ltd. (1978) 115 I.T.R. 640*, and consequently even if the business losses unabsorbed depreciation, investment allowance etc., of the new unit, are absorbed by the profits of any old unit or any other source of income owned by the same, assessee, subsequently, when the new unit starts yielding profits, for the purposes of determining the quantum of deduction under Section 80I, such past losses depreciation, Investment allowance etc, should be brought forward notionally on the

assumption, that the new industrial unit is the only source of income owned by the assessee. In this case, however, only the depreciation and investment allowance relating to the new unit have been absorbed by other profits and no losses of the new undertaking have been so absorbed.

In view of this position, Bharat Industrial Enterprises Pvt. Ltd. can claim the benefit of deduction under Section 80I only for the assessment year 1984-85 and even for that purpose, the profits have to be computed under Section 80I(6) in the manner indicated above.

Compulsory Audit : For an assessee other than a company or a cooperative society, to get the benefit of deduction under section 80I, it must have the accounts of the undertaking for the relevant previous year duly audited and produce the auditor's report in the prescribed form along with the return.

Transaction between a new unit and other units of the assessee :

There may be departmental transfers of goods, an existing unit supplying goods to the new unit or the new unit supplying its products to the existing units. If the transfers are at values which do not correspond to the market value of the goods as on the date of the transfer, then for the purposes of the deduction under section 80-I, the profits and gains of the undertaking are to be computed as if the transfer were made at such market value. But if computation presents exceptional difficulties the ITO may compute the profits on such reasonable basis as he may deem fit.

Transactions between closely connected persons :

Where the assessee arranges transactions between the new unit and closely connected persons in such a way as to produce more than the ordinary profits which might be expected to arise in the new unit, the ITO is entitled to substitute for the stated profits such ordinarily expected profits for the purposes of determining the quantum of benefit under Section 80-I.

Power of Central Government : The Central government has power to direct by notification that the exemption under section 80-I shall not apply to any particular class of industrial undertaking with effect from a particular date.

The Finance Act 1983 has made the following amendments to section 80-I.

Where the gross total income of an assessee being an Indian company includes any profits and gains derived from the business of repairs to ocean-going vessels or other powdered craft, a deduction shall be allowed of 20% of such profits in the initial assessment year and each of the four succeeding assessment years, subject to the fulfilment of certain conditions (similar to those to be filled up by hotel or shipping businesses). Such business should have commenced after the 31st March, 1983 but before 1st April 1988 and must, for the time being, be approved by the Central Government.

This amendment will apply from 1984-85 assessment year onwards.

Example : Mr. A set up a new industrial undertaking in a notified backward area in May 1983. The industrial undertaking commenced its business of manufac-

ture of a priority item in June 1983. During the previous year ended 31st Dec. 1983, Mr. A's Gross Total Income includes Rs. 2 lakhs derived from the new industrial undertaking. The value of plant and machinery of the undertaking was Rs. 10 lakhs as on 31st Dec. 1983.

During the year it had exported goods worth Rs. 5 lakhs outside India. The sale proceeds are received in convertible foreign exchange. Indicate the deduction allowable from Gross Total Income of Mr. A in respect of the above transactions.

Answer : Mr. A set up a new industrial undertaking in a notified backward area. The total value of plant and machinery as on the last day of the prveious year i.e., 31st Dec. 1983 was Rs. 10 lakhs. So it is a small scale industrial undertaking as per Explanation given under Sec. 80HHA. The small scale industrial undertaking is engaged in the business of manufacturing a priority item. Hence Mr. A would be entitled for deduction under Sec. 80HH, Sec. 80HHA, Section 80I in respect of profits and gains of industrial undertaking included in his Gross Total Income for the relevant previous year. But the assessee cannot claim the benefit of deduction both under Sections 80HH and 80HHA in view of the specific provisions of sub-section (9A) of Section HH which provides that no deduction would be allowed under that section in respect of profits and gains in relation to which deduction is allowable and claimed under Section 80HHA. Hence the assessee would be entitled to claim deduction under Sections 80HH or Section 80HHA.

It is assumed that the assessee has opted for claiming deduction under Section 80HH. So, the assessee is entitled for a deduction of 20% of Rs. 2,00,000 i.e., 40,000 under Section 80HH.

The quantum of deduction allowable under Sec. 80I shall be 20% of profits and gains from industrial undertaking as reduced by the deduction allowed under Section 80HH i.e. 20% of Rs. 1,60,000 [Rs. 2,00,000—Rs. 40,000]=Rs. 32,000.

As per Sec 80HHC, Mr. A shall be entitled for deduction of one per cent of sale proceeds of export goods made outside India during the previous year i.e., one per cent of Rs. 5 lakhs=Rs. 5,000. Assuming that Mr. A did not make any exports during the previous year ended 31st Dec. 1982, no further deduction is allowed as envisaged in Sec. 80HHC(1) (b) read with sub-section (3).

Hence Mr. A shall be entitled for an aggregate deduction of Rs. 77,000 [Rs. 40,000, Rs. 32,000 and Rs. 5,000 under Sec. 80HH, 80-I and Sec. 80HHC respectively] from his Gross Total Income for the previous year ended 31st Dec. 1983 relevant to the assessment year 1984-85.

Deduction in respect of profits and gains from newly established industrial undertakings or ships or hotel business in certain cases : (80J),

The tax holiday provisions of Secion 80J have got only limited importance now in view of the fact that the benefit under the provisions of Section 80J would be available only in relation to new industrial undertakings which went into production *before 1st April, 1981* or approved *hotels* which started functioning *before that date* or new *ships* which were brought into use on or *before that date.*

The tax holiday concessions under Section 80J consists of exemption of income-tax on the profits upto 6% per annum (7.5% per annum in the case of

companies) of the capital employed in the industrial undertaking, hotel or ship for five successive assessment years commencing from the assessment year relevant to the previous years in which the undertaking goes into production or starts operation of the cold storage plant or the hotel starts functioning or the ship is first put to use. The deduction is to be made in respect of the profits and gains of the industrial undertaking included in the gross total income as reduced by the deduction, if any, allowable under section 80HH or 80HHA. In the case of co-operative society, the tax holiday period extends to seven years as against five years in the case of other categories of assessees. An industrial undertaking which began to manufacture or produce any article specified in the list of the Eleventh Schedule to the Income-tax Act after 31st March, 1979 is not eligible for this tax concession.

The tax holiday benefit is based on a specified percentage of the capital employed, The capital employed in the industrial undertaking or a ship or the hotel is computed on the basis laid down in sub-section (IA) of Section 80J.

Under this sub-section, capital employed is computed on the basis of owned capital and reserves only and the value of the total assets of the assessee are reduced by the liabilities including long-term borrowings.

Section 80J (3) allows the benefit of carry forward of and set off of the 'deficiency' in the profits for the period of five years in the case of assessees other than cooperative societies and seven years in the case of cooperative societies. The provisions as regard the computation of deficiency and its set off are as follows :—

(1) The term "deficiency" in the context refers to the amount of difference between the relevant amount of the capital employed during the previous year and the amount of profits and gains derived from the industrial undertaking or ship or the business of the hotel, as the case may be, included in the gross total income as computed without applying the provisions of Section 64 and before making any deduction under Chapter VIA or section 280-O. In cases where there are no such profits and gains, the word "Deficiency" will refer to the relevant amount of capital employed during the previous year.

(2) The deficiency for each year shall be computed separately and added in on cumulative basis so as to prevent the loss of one year from the set off against the profits of any earlier years during the five years or seven years period. If there being more than one deficiency the deficiency brought forward from the earlier previous year shall have priority over the efficiency of the subsequent previous year for the purpose of setting it off.

(3) The assessment year in respect of which the deficiency is to be carried forward must not be an assessment years prior to the initial assessment year or subsequent to the four or six assessment year, as the case may be, as reckoned from the end of the initial assessment year.

(4) The deficiency of one year is to be carried forward and set off against the profits and gains of the industrial undertaking, hotel or ship after the deduction, if any, available to the assessee under Section 80HH or 80HHA for the next following assessment years. However, in new

industries, the deficiency or part thereof shall not be carried forward beyond seven assessment years, as reckoned from the end of the initial assessment year.

(5) Where the assessee is entitled to a deduction under Section 80HH or Section 80HHA and 80J, the deduction under Section 80HH or 80HHA should be first allowed and only thereafer the deduction under Section 80J should be allowed.

Students may note that the provisions of section 80J are similar to those of section 80I in respect of the following matters :

1. Conditions to be fulfilled by industrial undertakings, ship, hotel.

2. Audit.

3. Transactions between the new units and the other units belonging to the assessee.

4. Power of the Central Government.

Deduction in respect of profits and gains from business of livestock breeding or poultry or dairy farming : (80 JJ).

According to this provision an assessee deriving income from the business of livestock breeding or poultry or dairy farming would be entitled to deduction, in the computation of his total income, of an amount equal to one-fifth (15 per cent from 1-4-1984 as per Finance Act 1983) of the aggregate of the income derived from these sources or Rs. 15,000, whichever is higher. Where the aggregate of such income does not exceed Rs. 15,000, the whole of such income will be extempt from tax. It computing the deduction under this Section in a case where the profit derived from the business of poultry farming exceeds Rs. 75,000 (Rs. 1,00,000 w.e.f. 1.4. 1984 as per Finance Act 1983) the excess will be ignored.

Deduction in respect of profits and gains from business of growing mushrooms : (80 JJA)

The Finance Act, 1979 has inserted a new Section 80JJA in the Income-tax Act, with effect from 1st April, 1980 to grant a deduction from gross total income in cases where the gross total income of the assessee (whether corporate or non-corporate and whether resident or non-resident) includes in profits and gains derived from the business of growing mushrooms provided that such profits and gains are not in the nature of agricultural income. The amount of deduction shall be a sum equal to 1/3rd of such profits and gains or Rs. 10,000, whichever is less.

As per the Finance Act 1983, 80JJA will be omitted w.e.f. 1984-85 assessment year.

Deduction in respect of dividends attributable to profits and gains from new industrial undertakings or ships or hotel business : (80K)

A shareholder of a company is not liable to pay income-tax in respect of so much of dividends received by him from the industrial undertaking, or ship as is

attributable to the tax-holiday profits exempt from tax in the hands of the industrial undertaking or hotel or ship under section 80J. The assessee is allowed a deduction from his gross total income of the amount of such dividends to the extent to which they relate to the 'tax holiday' profits of the company computed as per Rule 20 of the Income-tax Rules 1962. The benefit of this deduction is available to the beneficial owners of the shares who need not necessarily be the registered shareholders.

The proviso to Section 80K of the Income tax Act provides that no deduction under this Section shall be allowed in respect of any income by way of dividends which is attributable to the profits and gains derived by a company from a new industrial undertaking which begins to manufacture or produce articles or to operate a cold storage plant at any time after 31st March, 1976 or from a ship which is brought into use after that date or even from the business of a hotel which started functioning after that date.

In other words such dividends are not exempt at all. Thus section 80K has now become considerably restricted in its operation.

Deductions in respect of interest on certain securities : (80L as amended by Finance Act, 1984)

The income derived from any of the following sources will be exempt from income-tax in the case of individuals and Hindu undivided families, subject to a maximum of Rs. 7,000.

(i) Interest on any security of the Central Goverment or a State Government issues come under this category. For instance, interest of NSC-VI and VII.

(ii) Interest on such debentures of co-operative societies (including co-operative land mortgage banks and co-operative land development banks) or other institutions or authorities as are notified by the Central Government. [The debentures issued by State Electricity Boards after 1-4-1972 and the Industrial Finance Corporation of India have been notified in this regard.].

Interest on deposits under such National Deposit Scheme as may be framed by the Central Government and notified by it in this behalf in the Official Gazette.

(iii) Interest on deposits made under any scheme framed by the Central Government and notified in this behalf : [The Post Office Time Deposits and Post Office Recurring Deposits have been notified for this purpose].

(iv) Dividends from Indian companies.

(v) Income from the Unit Trust of India.

(vi) Interest on deposits with banking companies and co-operative societies carrying on banking business including co-operative land mortgage banks and co-operative land development banks.

(vii) Interest on deposits with a financial corporation engaged in providing long term finance for industrial development in India and which is approved by the Central Government for the purpose of Section 36 (1)(viii)

(vii *a*) Interest on deposits with any bank, other than a banking company or a cooperative society referred to in (vii) above which may be approved by the Central Government.

(viii) Interest on deposits with a co-operative society [other than a co-operative society referred in (vi) above] made by a member of the society—with effect from 1-4-1972.

(ix) Dividends from any co-operative society.

(x) Interest on deposits with housing boards.

(xi) Interest on deposits with approved financial corporations providing term finance for industrial development or approved public companies providing long term finance for construction or purchase of houses in India for residential purposes.

Under the Compulsory Deposit (Income-tax Payers) Act, 1974 the interest received bp the tax-payers on their deposits would also qualify for deduction under Section 80L. Likewise, the interest received by employees on their additional wages and dearness allowance frozen under the Additional Emoluments (Compulsory Deposit) Act, 1974 would also qualify for deduction under this Section as interest from banks).

Additional deductions : The Finance Act, 1984 has added two provisos to section 80L(1) with effect from 85-86 assessment year.

1. The first proviso places investment in units of the Unit Trust of India and investment in National Deposit Scheme on par and allows a further deduction of Rs. 3,000 from income derived from these two sources.
2. The second proviso provides for a further deduction of Rs. 2,000 in respect of income derived from investment in National Deposit Scheme.
3. **Additional Exemption in respect of Units in the case of non-residents.** In addition to the exemption available under Section 80L in respect of income from specified sources including units, which is available to all individual and Hindu undivided family assessees, there is a special exemption in respect of units applicable to non-resident. As a result of the amendment made by the Unit Trust of India (Amendment) Act, 1976 income earned from Units of the Unit Trust of India purchased by non-resident Indians and aliens of Indian origin from Non-Resident (External) accounts or through remittance of-foreign exchange will be free of income-tax. There is no monetary ceiling in this regard.

Students may note that the additional deduction of Rs. 3,000 available in respect of income from units under Unit Trust of India Act, 1963 wlll be withdrawn from 85-86 assessment year, since the same has been incorporated in section 80L(1) of the Income-tax Act itself.

Where the total income of an assessee also includes any dividends which are exempt from tax under Section 80K as being attributable to the tax holiday profit of companies, only that part of dividends in respect of which deduction is not allow-

able under the Section (80K) will be taken into account for the purpose of allowing the deduction under this Section.

Deduction in respect of certain intercorporate dividends : (80 M)

Section 80M provides for concessional tax treatment of intercorporate dividends. Till 84-85 assessment year full deduction will be granted in respect of income by way of dividends received by a domestic company from an *Indian company* formed and registered under the Companies Act, 1956 after 28th February, 1975 and engaged exclusively or almost exclusively in the manufacture or production of any one or more of the specified articles in this connection,

In respect of such income by way of dividends other than the dividends referred to above the deduction is allowed at the rate of 60 per cent of such dividend income.

However, by virtue of an amendment made by the Finance Act, 1984, this differential concession has been abolished and a uniform rate of deduction at 60% for all inter-corporate dividends will be available from 85-86 assessment year onwards.

The income by way of dividends is charged to tax under the head "Income from other sources" and is computed after making the deduction firstly, in respect of any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purposes of realising such dividends on behalf of the company and, secondly, in respect of any other expenditure, not being capital expenditure laid out or expended wholly or exclusively for the purpose of making or earning such income, e.g , interest paid on borrowings utilised for the purchase of shares, etc.

Section 80AA provides that the deduction under Section 80M in respect of inter-corporate dividend will be calculated with reference to the net dividend income as computed in accordance with the provisions of the Income-tax Act (before making any deduction under Chapter VIA) and not with reference to the gross amount of such dividends. Students may refer to the general introduction for Chapter VIA to understand the significance of the provisions of section 80AA.

The Finance Act, 1983 has omitted section 80MM with effect from the assessment year 1984-85.

Deduction in Respect of Dividends from Certain Foreign Companies (Section 80N) : *Indian companies* receiving dividends from foreign companies on shares allotted to them by the latter in consideration of any patent, invention, design, model, secret formula or process or similar property right, information concerning industrial, commercial or scientific knowledge, experience and skill provided by them to the foreign companies are entitled to a deduction of the *whole* of such dividends (50% of such dividends from 85-86 assessment year onwards) from their gross total income.

This deduction is available to the assessee even in respect of dividends on shares allotted in consideration of any technical knowhow provided by it to the foreign company if it is provided under an agreement approved by the Board for

this purpose the application for which should have been made before 1st October of the relevant assessment year.

The deduction under Sec. 80N would be available to the Indian company *only if* the dividend income is brought into India in accordance with the Foreign Exchange Regulation Act and the rules made thereunder. The deduction mentioned in the Section should be allowed only with reference to the income referred to which is received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, by or on behalf of the assessee is subsequently brought into India in accordance with the law for time being in force for payments and dealings in exchange.

For the purposes of this section "convertible foreign exchange" means foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purpose of Foreign Exchange Regulation Act.

It is possible that the assessee might use some portion of the income outside India. If such income is used outside India in the manner permitted by the Reserve Bank of India then it shall be deemed to have been brought into India in accordance with the Foreign Exchange Regulation Act on the date on which such permission is given.

It is likely that in some cases there might be considerable time lag between the accrual of income in a foreign country and is remittance to India and accordingly a situation may arise where foreign income may not be received in India before the completion of regular assessment for the year in which it becomes chargeable to tax in the case of a tax-payer maintaining accounts on mercantile basis. A similar difficulty may also arise in cases where a host country may place restrictions on remittance of funds to India and the income otherwise qualifying for exemption may not be received in India before the assessment is made. In order to obviate these difficulties section 155(11) provides that in cases where the deduction under section 80N was not allowed in any year in respect of the whole or any part of the income by way of dividends on the ground that such income had not been received in convertible foreign exchange in India or having been received in convertible foreign exchange outside India, had not been brought into India by or on behalf of the tax-payer in accordance with the foreign exchange regulations and subsequently such income or part thereof is received in or brought into India in accordance with these regulations, it will be open to the income-tax officer to rectify the original assessment so as to allow the deduction in respect of income so received in or brought into India. The rectification will be permissible within the period of four years from the date on which such income is received in or brought into India.

Deduction in respect of royalties etc., from certain foreign enterprises : (80-O)

Under this Section an Indian company is entitled to a deduction from gross total income in respect of the whole of the royalties, commission, fees or other similar payment included in the gross total income. From 85-86 assessment year onwards the deduction will be restricted to fifty per cent of such income included in assesseess Gross Total Income. The provisions in this regard are as under :—

(i) The income by way of royalties etc., should have been received by the assessee from the Government of foreign State or a foreign enterprise. For this purpose it is immaterial whether the foreign enterprise is a company or not.

(ii) The income must have been received (a) in consideration for the use outside India of any patent, invention, model, design, secret formula or process or similar property right or information concerning industrial, commercial or scientific knowledge, experience or skill made available or provided or (b) in consideration of technical services rendered by the assessee to the foreign government or enterprise.

(iii) The deduction will be admissible only in cases where the technical services are rendered or the technical know-how is provided to a foreign government or enterprise under an agreement approved by the Central Board of Direct Taxes for this purpose.

(iv) The application for approval must be made to the Board before the 1st October of the assessment year in relation to which the approval is first sought by the assessee.

(v) The other conditions relating to the receipt of this income in convertible foreign exchange and its remittance into India in accordance with the Foreign Exchange Regulations Act and the Rules made thereunder which are applicable to the deduction under Section 80N apply as well to the deduction under this Section.

Deduction in respect of income of cooperative societies :

Under Section 80P the profits and gains of business carried on by a co-operative society and included in the gross total income of the society from the following type of business would be totally exempt from tax. The exemption is given by way of a deduction from the gross total income. The following items of income would be totally exempt from tax for all purposes of assessment without any monetary or other limits :

(i) income from the business of banking or providing credit facilities to its members ; or

(ii) income from a cottage industry ; or

(iii) income from the marketing of the agricultural produce of its members ; or

(iv) income derived from the purchase of agricultural implements, seeds, live-stock or other articles intended for agriculture or for the purpose of supplying them to its members ; or

(v) income from processing, without the aid of power, of the agricultural produce of its members ; or

(vi) income derived from supplying milk raised by the members to a federal milk co-operative society ;

(vii) the business income of labour co-operative societies as well as societies engaged in fishing and other allied pursuits, such as, catching, curing, processing, preserving, storing, and marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to their members. However, the exemption in respect of this type of income will be available only in the case of those co-operative societies which, under their rules and bye-laws, restrict the voting rights to members who constitute the labour force or who actually carry on the fishing or other allied activities.

Section 80P also provides that in the case of a co-operative society being a primary society engaged in supplying milk oilseeds, fruits or vegetables raised by its members to a federal milk co-operative society or the Government or a local authority or a Government company or a statutory corporation established by or under a Central, State or Provincial Act (being a company or corporation engaged in supplying such articles to the public) the *whole* of the amount of profits and gains of such business would be exempt from tax by way of deduction from the gross total income of the co-operative society.

2. Further, a co-operative society which is engaged in activities other than or in addition to those mentioned above, is not liable to pay any income-tax on the first Rs. 20,000 of its business income arising from other activities. Thus a co-operative society which is engaged in any business activity besides any of the business activities mentioned in clauses (i) to (iii) of item 1 above would not be liable to pay any income-tax on the whole of its income derived from any of the activities specified and also on the first Rs. 20,000 of its business income from activities other than those aforesaid. However, with effect from 1-4-1980 consumers' co-operative societies would be entitled to a deduction of Rs. 40,000 from their gross total income as against Rs. 20,000 allowable in other cases.

The deduction in respect of business profits is not restricted to the profits from the business of the society with its members alone but is available in respect of profits from any business carried on by a co-operative society with non-members as well. The interest received by a co-operative society on deposits made from its circulating capital is deductible as being a part of the profits of its banking business. Interest on securities held by a co-operative society as the stock-in-trade of the banking business carried on by it is wholly deductible under 1 (i) above.

3. Any income arising to a co-operative society by way of any interest and dividends derived from its investments with any other co-operative society is deductible in full from its gross total income.

4. Any income arising to a co-operative society, chargeable under the head 'interest on securities' (Section 18) or 'income from house property' (Section 22) is not chargeable to income-tax in cases where the total income of the co-operative society does not exceed Rs. 20,000 and it is not a housing society or an urban consumers' society or a society engaged in the performance of any manufacturing operations with the aid of power. Thus, a majority of small co-operative societies would not have to pay any income-tax.

5. The income of a marketing society derived from the letting out of godowns or warehouses for storage, processing or facilitating the marketing of commodities is totally exempt from tax.

6. Further, where the co-operative society is also entitled to the deductions available under Sections 80HH, 80HHA, 80HHB, 80HHC, 80I, 80J, 80JJ, and the deduction under this Section [i.e., 80P(1)] shall be allowed with reference to the total income as reduced by the deduction allowable respectively under .tions 80HH, 80HHA, 80HHB, 80HHC, 80I, 80J and 80JJ.

Deduction in respect of profits and gains from the business of publication of books : (80QQ).

Under section 80QQ, any person carrying on a business, in India, of the printing and publication of books or publication of books without the activity of printing, is entitled to a deduction, in the computation of his total income of an amount equal to 20% of the profits from such business included in his gross total income. The deduction is admissible for the assessment years 1971-72 to 1985-86.

The section makes it clear that the expression "books" in this context does not include newspapers, journals, magazines, diaries, brochures, tracts, pamphlets and other publications of a similar nature, by whatever name called.

Where the publisher is entitled to deductions under section 80HH, 80HHA, 80I, 80J, or 80P then section 80QQ is to apply only to the profits and gains of the publication business as reduced by the deductions under the said sections.

Deduction in respect of professional income of authors of text books in Indian languages (Section 80QQA)

Under Section 80QQA, authors of standard text books prescribed for a degre or Post Graduate Course of a University in any language specified in the Eightl Sehedule to the Constitution of India or in any other language which the Centra Government may notify, having regard to the need for promotion of publicatio of such text books in that language and other relevant factors, would be entitled t a deduction, in computing the total income of a sum equal to 25% of the incon from such books included in the gross total income. The deduction is admissible f the assessment years 1980-81 to 1984-85 (both inclusive). In order to qualify f this deduction what is material is that the income must arise to the assessee duri the previous year relevant to the aforesaid assessment years in accordance with t method of accounting followed by the tax-payer coupled with the further conditi that the author must be an individual resident in India. The income derived by t assessee in exercise of his profession as author must be included in the total inco of the relevant assessment year ; it is however, immaterial whether such inco represents any lumpsum consideration for the assignment or grant or any interest the copyright of any book or of royalties or copyright fees receivable in lumpsum otherwise in respect of the text book. The text book, the income from wh qualifies for deduction, should be in nature of a dictionary, thesaurus or ency paedia or a text book prescribed or recommended by any University for a degre Post Graduate Course. For this purpose the expression *'author'* must be take include the joint author. Any lumpsum amount receivable in regard to roya or copyright fees must be taken to include an advance payment on account of royalties or copyright fees if it is not refundable.

Remuneration received by an assessee from a foreign University etc. (Se 80R) : According to this section Indian citizens receiving remuneration ou

India from any University or other educational institution or association or body established outside India and approved for this purpose for their services rendered outside India as a professor, teacher, research worker in such University, institution, association or body are entitled to a deduction of 50% of such remuneration received by them. But the question of deduction arises only where the income is otherwise taxable in India. Thus if the assessee is a non-resident individual, the deduction would not be available. This benefit, however, is available to the assessee for a maximum period of thirty six months, where he continues to render such a service outside India for more than 36 months no deduction is allowable in respect of the remuneration for the services rendered after the expiry of the first 36 months. The Finance Act 1983 has done away with the requirement of notification. Accordingly, the deduction in respect of remuneration from foreign sources in the case of professors, teachers etc. will now be available where such services are rendered not merely in any University or other educational institution but also to any other association of body without the necessity of it being notified. This will be effective from 84-85 assessment year onwards.

11. Deduction in respect of professional income from foreign sources in certain cases (Section 80RR) : This Section provides tax concession to individuals who are authors, playwrights, artists, musicians, actors or sportsmen (including athletes) who derive income from foreign sources.

The concession is given by allowing a deduction of an amount equal to 25% of the income derived from foreign sources from out of the gross amount of such income included in the assessee's total income. For this purpose it is immaterial whether the assessee is an Indian citizen or not. The conditions under which the relief is admissible are :

(i) The person must be a resident of India during the relevant previous year.

(ii) The income is derived from foreign sources in exercise of a professic

(iii) The income is received in India or is brought to India in the shape of foreign exchange in accordance with the Foreign Exchange Regulations Act, 1973 and the Rules made thereunder.

Deduction in respect of remuneration for services rendered outside India : Section 80RRA provides that employees would be entitled to deduction from their gross total income in respect of remuneration received for services rendered outside India. According to this provision, any individual who is a citizen of India and who receives any remuneration in foreign currency from an employer for services rendered by him outside India would be entitled to claim a deduction from his gross total income in all cases where the amount of remuneration is included in the gross total income. The amount of deduction allowable under this Section shall be a sum equal to 50% of the amount of such remuneration due to or received by the employee. If the employee renders continuous service outside India for a period exceeding 36 months, no deduction would be allowable in respect of the remuneration for such services relating to any period after the expiry of the 36 months. In the case of an individual who is or was, immediately before undertaking

the foreign service in the employment of the Central Government, the deduction is allowable only if his services are sponsored by Central Government. In the case of any other individual the allowability of this deduction is subject to the condition that the assessee is a technician and his contract of service under or with the foreign employer is approved for this purpose by the Central Government or the prescribed authority.

The benefit of deduction under this provision would be available in every case regardless of the fact who the employer is. Such an employer may be a foreign employer of an Indian concern, utilising the services of the Indian citizens outside India, if the employer is a foreign employer', such foreign employer may be the Government of a foreign State or a foreign enterprise or any association or body established outside India.

The deduction of a sum equal to 50 per cent of the amount of remuneration received by individuals who are citizens of India would be allowed from their gross total income only if such remuneration is received in the foreign currency from any employer for services rendered outside India. If however the remuneration for services rendered outside India is received in Indian currency, the benefit of deduction would not be available; prior to this amendment the admissibility of the deduction was not in any way dependent on the receipt of the remuneration in foreign currency. If the remuneration is received partly in Indian currency and partly in foreign currency, the deduction would be allowable only with reference to that portion of the remuneration which is received in foreign currency. The new amendment does not, however, make it clear as to the entitlement of the employee to claim deduction in cases where the remuneration is not received in foreign currency but continues to be remaining due to him from the foreign employer as a result of the payment not being actually made.

The term "*technician*" means a person having specialised knowledge and experience in —

(i) Constructional or manufacturing operations or in mining or in the generation and/or distribution of electricity or any other form of power: or (ii) agricultural, animal husbandry, dairy farming, deep-sea fishing or ship building or (iii) public administration or industrial or business management ; or (iv) accountancy ; (v) any field of natural or applied science (including medical seience) or social science ; or (vi) any other field which the 'Central Board of Direct Taxes may prescribe in this behalf. In order to be eligible for the tax concession, it is essential that the technician must be employed in a capacity in which his specialised knowledge and experience in respect of the field of his specialisation are actually utilised in the course of his rendering services outside India.

Deduction in respect of compensation for termination of managing agency etc. in the case of assessees other than companies : (80S)

An assessee is entitled under this section to a deduction from his gross total income in respect of the compensation for termination of managing agency and other income chargeable to tax under sub-clauses (a), (b) and (c) of clause (ii) of **Section 28(ii). The conditions of this deduction are as under :**

(i) The person should be an assessee (other than a company) resident in India.

(ii) The compensation or other income included in the gross total income must be chargeable to tax as income from business under section 28(ii) of the Act.

(iii) The person should be managing the whole or substantially the whole of the affairs of an Indian company or any other company in India.

(iv) The person should be holding an agency in India for any part of the activities relating to the business of any other person.

(v) The compensation or other income should have been received at or in connection with the termination of the agency or the modification of terms and conditions relating thereto.

The amount of deduction shall be a sum equal to 25% of the amount of compensation or other income included in the gross total income or Rs. 1,00,000 whichever is less. It is to be noted that the compensation received by an assessee in respect of the vesting in the Government of the management of the business of the industrial undertaking, etc., which was taken over by the Government would *not* qualify for the deduction from gross total income although it is taxable as income from business like the compensation for termination of managing agency of any other agency.

Deduction in respect of Long-term capital gains (LTCG) in the case of assessees other than companies : (80T)

Section 80T provides for an allowance of a straight deduction, in the computation of the total income of non-company assessees, in respect of long term capital gains included in their gross total income.

Position from assessment year 1983-84

As a result of the amendment of section 80T and the insertion of the Twelfth Schedule by the Finance Act, 1982 with effect from 1-4-1983 the position will be as follows :

Where the LTCG do not exceed Rs. 5,000 the whole of such long-term capital gains will be allowed as a deduction.

Thereafter the deduction is to be based on the number of years for which the relevant long-term capital assets have been held by the assessee. For this purpose a two-fold classification has been maintained and the rate of deduction is as follows :

Period (in years) of holding of the capital assets	Rate of deduction in respect of LTCG relating to buildings or lands	Rate of deduction of LTCG relating to other capital assets
Not less than 3 but not exceeding 5	25%	40%
,, 5 ,, 10	28%	45%
,, 10 ,, 15	33%	50%
,, 15 ,, 20	37%	55%
over 20 years	40%	60%

Where the LTCG relate to gold, bullion or jewellery, the maximum deduction admissible under section 80T is to be restricted to Rs. 50,000.

Where the assessee has LTCG relating to land and buildings and also other assets.

In this case the initial deduction of Rs. 5,000 is to be given first in respect of LTCG relating to land and buildings and if such LTCG are less than 5,000, the balance is to be adjusted against LTCG relating to gold-bullion or jewellery and the balance, if any, against LTCG relating to any other capital assets.

Deduction in respect of winnings from lottery : (Section 80TT)

In computing the taxable income of all non-corporate assessees where the lottery winnings do not exceed Rs. 5,000, the whole of such winnings will be allowed as a deduction. In other cases, the deduction allowable to the assessee would be a sum equal to Rs 5,000 plus 50% of the balance of the income by way of lottery winnings.

Deduction in the case of totally blind or physically handicapped resident persons (80U)

Totally blind individuals resident in India are allowed a straight deduction of Rs. 10,000 in computing their taxable income every year. A similar benefit is also available to individuals who are subject of or, suffering from a permanent physical disability (other than blindness which has the effect of reducing substantially his capacity to engage in gainful employment or occupation. It should be a permanent physical disability specified in the rules made in this behalf by the Board. However, in order to be eligible for the aforesaid deduction of Rs. 10,000 the assessee must furnish in respect of the first assessment year for which the deduction is claimed in the case of total blindness a certificate, from a registered aculist and in the case of any permanent physical disability stated above, certificate from a registered medical practitioner. For subsequent assessment years such a certificate need not be produced.

III. Rebate of tax and Relief in certain cases :

(*1*) *Income from unregistered firm* : Under Section 86 (iii), an assessee is exempted from tax on his share income derived as a partner of an unregistered firm computed in accordance with the provisions of Section 67 of the Act, and on which income-tax is payable by the firm. If the firm is not chargeable to tax the partner will not be entitled to the rebate under this Section.

The share of the partner of an unregistered firm is required to be reckoned in accordance with the manner prescribed by Section 67, *viz* the partner's share of profits shoul include any interest, salary, commission or other remuneration payable to him by the firm *over* and *above* his share in the balance of the firm's profits. Consequently, these inclusive items of receipts are exempt from tax in his (recipient partner's) hands provided that the other conditions for exemption have been complied with. Further, according to Section 40(b) the amounts paid by the firm to its partner on the aforementioned accounts are not deductible from the profits of the firm. These receipts are not taxable once again in the hands of the partner since they are taxed as the income of the firm.

(*2*) *Income from association of persons or bodies of individuals* : If the assessee is a member of an association of persons or a body of individuals (other than a H.U.F., a company or a registered firm) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body [Section 86(v)]. For the purposes of this provision in the case of an association of persons which is assessable under Section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be deemed to be entitled to receive equal share in the income of the A.O.P. and the individual share of such member will be determined accordingly.

(*3*) *Deduction from tax on certain (tax-free) securities (Section 86A)* : Where interest on any security either of the Central Government or that of the State Government, issued or declared to be income-tax free, is included in the total income, the assessee is entitled to a deduction from the amount of tax with which he is chargeable on his total income of an amount equal to the income-tax calculated on the amount included on account of interest on such securities at the average rate of income-tax or at the rate of 27½%, whichever is less.

However, these items of receipts are includible in the total income of the assessee for ascertaining the average rate of tax applicable to him.

(*4*) *Relief when salary etc. is paid in arrears or in advance (Section 89)*. It has already been explained in the Study Paper relating to salaries that arrears or advances of salaries are assessable in the hands of the recipients in the year these are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than 12 months. Likewise any payment in the nature of profit in lieu of salary [within the meaning of Section 17(3) of the Act], is also chargeable in the year of receipt in addition to the normal salary received by the employee. In consequence, the aggregate salary income may become liable to tax at a rate higher than that at which it would otherwise have been assessed. To obviate such a hardship, the Income-tax Officer has been empowered to grant relief

in appropriate cases, on the employee making an application, in accordance with Rule 21 A of the Income-tax Rules.

We also know that interest on securities may be assessed as the income of previous year in which it had accrued for payment or that in which it has been received. In consequence, when it is received in arrears, the assessee's total income would be assessable at a higher rate than that at which it would otherwise have been assessed. To obviate such a hardship in appropriate cases, the Income-tax Officer has been empowered by the Section to grant relief on the assessee making an application in the prescribed form verified in the prescribed manner, in accordance with Rule 21 B of the Income-tax Rules.

(5) *Special concessions allowable in the case of income from royalties etc.* (*Section 180*) : Authors of literary and artistic work are entitled to spread their income over a period of three years, where the time taken in the execution of the work is more than twelve months and the amount is received in a lumpsum or by way of royalties or copyright fees, including sums received in a lumpsum or by way of advance. A claim has to be made by the assessee for obtaining relief under this Section.

This Section, however, has no bearing on the question whether the payments received by the author, writer or artist are income or capital. Therefore, whether the receipt in question is taxable or not is to be decided in the light of the particular circumstances of the case. The effect of this section is not to bring to charge any amount which on general principles is a non-taxable receipt.

The method of spreading the income and the tax payable thereon over a period of three years as prescribed in Rule 9(2) of the Income-tax Rules 1962 is as under :

(i) The tax for the assessment year relevant to the previous year in which the whole amount was received shall be—

(a) The amount of tax payable on the total income reduced by 2/3rds of the amount of royalties or copyright fees included in the total income of the previous year aforesaid as if the total income so reduced had been the total of the previous year ; *plus*

(b) the tax on an amount equal to 2/3rds of the amount of royalties or copyright fees included in the total income of the previous year aforesaid at the rates applicable to a total income of an amount equal to 1/3rd of such inclusion ; and

(ii) 1/3rd of the amount of royalties or copyright fees included in the total income of the previous year aforesaid shall be includible in the total income of each of the two next succeding previous years and the tax payable, if any, in respect of each of the assessment year relevant to the two said succeeding previous years shall be reduced by an amount equal to one-half of the tax referred to in (i) (b) above.

In other words, one-third of the income will be included in the total income of three assessment years immediately succeeding the relevant previous year and will be taxed accordingly. In addition, in the first assessment year a deposit of

income tax on 2/3rds of the amount of such income will be payable at the average rate of tax for that year ; half the deposit so made will be adjusted against the tax of the second year and the remaining half in the third year.

ASSESSMENT OF HINDU UNDIVIDED FAMILIES

General : A Hindu undivided family is assessed to income-tax as a distinct entity or a unit of assessment. The expression 'Hindu undivided family' is not defined in the Act. We have therefore to ascribe to it the same meaning as it has according to the personal law of the Hindus.

A joint Hindu family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A Hindu coparcenary is a much narrower body including only those persons who acquire by birth an interest in the joint or coparcenery property. A joint Hindu family may be composed of smaller or branch of joint families which may hold properties in their own right and may themselves be assessable units as distinct from the apex joint family. It cannot be brought into existence by an agreement among strangers or even by relatives falling outside certain degree of relationships. The expression 'Hindu undivided family' is used in the Act with reference not only to one school of Hindu Law but to all schools. There can be a Hindu undivided family consisting of female member only, e,g,, widows of deceased coparceners.

Under the Hindu Succession Act, 1956 the share of properties which the widow of a member of a H U.F. inherits in the coparcenery property as well as the separate property of her deceased husband is taken by her as a full owner, and consequently, the income arising from such properties is taxable in her hands as an individual and not in the hands of H U.F. Where a H.U.F. consists of the mother and her minor sons, the mother can act as the manager of the H.U F. and would be answerable for the assessment proceedings against the family. The position would not in any way be affected by the fact that the manager is a female member or that the Karta of the family is not a male member or coparcener. The same would be the position even if the eldest male member, though a minor, looks after the affairs of the family.

The Supreme Court has held in *Gowli Buddanna v. C.I.T. (1960) 60 I.T.R. 293* that there need not necessarily be more male members than one to form a Hindu undivided family along with females and that, even if the family is reduced to a sole surviving coparcener with other female members, the property and income belong to the joint family and in respect of such income the tax is leviable on the joint family and not on male member as an individual The same principle applies to a case where joint family property is partitioned and the property is allotted to a copercener who has a wife but no male issue ; in such a case the income from the property is assessable as the income of the Hindu undivided family comprising the member and his wife and daughter (if any), and cannot be included in the assessment of the member as an individual.

A single person, male or female however cannot constitute a Hindu undivided family.

It may be noted that according to the Supreme Court's decision in C.W.T. v. *Champa Kumari Singhi (1972) 83 I.T.R. 720*, a Jain undivided family must be assessed as a Hindu undivided family ; it should not be assessed as an association of persons or a body of individuals. In order to be brought within the meaning of a Hindu

undivided family, it must necessarily be governed by the Hindu Law of succession in addition to its being undivided or joint.

Hindu Law: There are primarily two schools of Hindu Law *viz.*, Mitakshara and Dayabhaga which recognise certain distinct principle with regard to devolution of property belonging to a Hindu joint family or its division amongst the members of the family. The principal distinction between these two schools lies in the management and division of the ancestral property amongst the members of the family and the admission of the female members into Hindu coparcenery under certain circumstances. It is also to be noted that the argument that a joint family is formed under the Mitakshara Law on the date of the conception of a son in his mother's womb is not correct. This doctrine does not fit in with the scheme of the I.T. Act [T.S. Srinivasan v. CIT (1966) 60 ITR 36].

Dayabhaga	*Mitakshara*
1. A son has no right in the joint family property, so long as his father is alive.	1. A male child acquires a right in the family property the moment he is born.
2. At any point of time the shares of different members constituting the family in the joint family property are definite and ascertainable.	2. Such shares are merely definable but not precisely ascertainable until a partition takes place.
3. Co-parcenary interest in the joint family property of each coparcener does not pass by survivorship.	3. It passes by survivorship.
4. Son does not acquire any interest by birth in his father's self-acquired property.	4. Same position.
5. In the case of ancestral property son does not acquire by birth any interest. His right to the property arises for the first time only after his father's death. So long as father is alive, the income from ancestral property also is assessable as the income of the individual.	5. In the case of ancestral property the son acquires by birth an interest therein and therefore after the birth of son, the income from ancestral property becomes the income of a Hindu undivided family and is assessable as income of the family.
6. *Females as Corparceners* (*e.g.*) X dies leaving behind three sons A, B, C. The three inherit the property jointly and form a coparcenary although each shall inherit a definite share. Before partition B dies leaving widow (BW) and C dies leaving daughter CD. A, BW and CD shall be the members of the coparcenary. Thus, Dayabhaga law admits female members into the coparcenary, in certain circumstances, although they, by themselves, cannot originally form a coparcenary.	6. In the example, A will be the sole surviving coparcener.

Joint Family income and individual income :

1. **Income received in the capacity as a member :** Section 10(2) gives total exemption in respect of any sum received by an individual as member of a Hindu Undivided Family either out of income of the family or out of any impartial estate belonging to the family. This exemption would however be subject to the provisions of Section 64 (2).

2. **Conversion of separate property into property of HUF.** However to the above exemption there is an exception provided by Section 64(2) of the Act. Even though we have discussed this in the appropriate place it will be better to recapitulate.

Before this let us understand the concept of conversion. Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of Section '4(2) specifically provides that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner. It also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration—in other words, gifts. Accordingly, where an individual makes a direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or where he transfers his separate property to his family for less than its fair market value, the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

Example : A converts his self-acquired property into HUF property consisting of A, Mrs. A, B (A's major son) Mrs. B, C (A's minor son) on 1-4-1982. The annual income from such property is Rs. 12,00,000 (on 1-4-1983 a partition took place among the members of the family and the above converted property was divided amongst the members according to Hindu Law provisions. A has got a uniform income from other sources to the extent of Rs. 1,00,000. The HUF's income from other sources amounted to Rs. 80,000. Find out the taxable income of A and HUF for the assessment year 1983-84, 1984 85. Assume the financial year to be their previous year.

Assessment of A 1983-84 Assessment year. As per the provisions of Section 64(2) (b) the entire income derived from the converted property will be deemed to arise to A and not to the family. Hence included in A's individual assessment.

	12,00,000
other sources	1,00,000
	13,00,000

Assessment year 1984-85 Subsequent to partition. Section 64(2)(c) provides that on such partition the income derived from such converted property as is received by the spouse or minor child on partition shall ' deemed to arise to the spouse or minor *child from assets transferred indirectly* by the individual to the spouse or minor child and hence the income received by the spouse or minor child from such converted property shall be deemed to be the income of the transferor. Thus out of Rs. 12,00,000.

A's share is ¼th		Rs. 3,00,000
Mrs. A's share ¼th	Rs. 3,00,000	
C (minor son's share ¼th	Rs. 3,00,000	
		6,00,000
		9,00,000
	other source	100,000
		10,00,000

Assessment of HUF

Assessment year 1983-84. The proviso to section 64 (2) says that once income from converted property has been included in the total income of the individual, it will be excluded from the total income of the family. Therefore, Rs. 12,00,000 having already been included inA's individual assessment will not be again assessed in the family's assessment.

Other income	80,000
	80,000

Assessment year 1984-85. As per the provision of Section 64(2)(c) the income derived by A, his spouse and his minor child have already been included in his individual assessment. The share of B, A's major son, will be assessedin hisindividual assessment. Hence nothing is to be included in the family's assessment.

Other income	80,000
	80,000

Can a female member throw personal property into joint family hotchpot ?

A connected question here is that whether a female member can impress upon her personal property the character of joint family property. The right to blend is limited to coparceners and a female member of the joint family cannot blend her separate to property (even if she is an absolute owner thereof) with the joint family.property. To blend is to share along with others and not to surrender one's interest in favour of others to the exclusion of oneself. A Hindu female cannot therefore, "blend" because she not being a coparcener, has no right to demand a share in the joint family property by asking for a partition. But she can always

gift her absolute property to the family and then the property belongs to the family and the income arising out of the assets is to be taxed in the hands of the family. These principles emerge out of the Supreme Court's decision in the case of *Pushpa Devi* v. *CIT 1977) 109 ITR 730.*

3. **Business in the personal capacity of the Karta or member.** Where the Karta or any member of a joint family carries on a business on his personal account the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Now one important question arises. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position ? Consider the following example.

Eg-1 A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is a brilliant automobile engineer. Together they started a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son uualified in business administration, For starting the business the HUF had advanced an interest-free capital of Rs. 20,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.

Answer : It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a deteriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of *CIT* v. *Charan Dass Khanna & Sons (1980) 123 ITR 194 (Delhi).* If investment plays a minor role and it is "primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF." In the given example the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.

Eg-2 : The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished Rs. 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.

The position of treasurer and secretary requires considerable personal skill and integrity on the part of the incumbent. It is true that the security deposit might have been furnished by the HUF. However since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence students should carefully understand the following.

Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the

family. In such a case the fee, salary, commission or other remuneration received by the Karta, or any member of the family, in his capacity as Director or partner would also be taxable as income of the family. The reasons for this treatment are as follows :

(1) The income is earned by detriment to the joint family funds.

(2) It is earned with the aid of joint family funds.

(3) There is real and sufficient connection between the investment or the joint family funds and the income or remuneration earned.

(b) However, where the income is earned by the Karta or any other member of the family by the exercise of the personal skill the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

4. **Members of HUF and Partnership firms** : A Hindu undivided family can become a partner in a firm. However since it has no separate legal entity of its own, its Karta alone can be the partner in the firm representing the family. The corparcenary has no place in the partnership.

When the Karta of joint Hindu family enters into a partnership with strangers, the members of the family do not ipso facto become partners in that firm. They have no right to take in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law the Karta has the right when properly carrying on business to pledge the credit of the joint family to the extent of its assets. This liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener. A Karta of a HUF *representing the family* on the one hand, and a member of that family in his *individual capacity* can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise, in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

5. **Salary paid to Karta for managing family's business;** If remuneration is paid to the Karta of a Hindu undivided family under a valid agreement which is bona fide and in the interests of and expedient for, the business of the family and the payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

6. **Salary paid to member :** A Hindu undivided family can be allowed to deduct salaries paid to members of the family, if the payment is made as a matter of commercial or business expediency, but the services rendered must be to the family,

7. **Gifts by HUF :** A HUF as such is incapable of making a gift to any of its members. However the Karta of a HUF has power to gift out of joint family

property for certain approved purposes. The gifts should be reasonable. For example a father may make a gift of the ancestral movable properties of the joint family, of which he is the Karta, for the purpose of discharging duties prescribed by Hindu Law. The income of the joint family will stand reduced to the extent of the income arising out of the asset thus gifted out.

8. **Gifts to HUF :** Can an outsider make a gift to HUF ? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF. The answer to this question is as follows:

1. If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e. the income arising out of such gifted property can be assessed as income in the hands of the Association of persons.

2. If the HUF to which such a gift is made consists of a minimum of two coparceners, then the gifted property can be held by the members of the family as joint tentants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Basis of Taxation : Since the H.U,F. is separately assessed to income-tax the members of the family are given total exemption from income-tax under Section 10(2) in respect of any sum received by them out of the income of the family. After the total income of a Hindu undivided family, which is treated as a separate entity for the relevant previous year has been determined under the provisions of the Act, it is charged to income-tax at the rates given below. A separate rate schedule governs a H.U.F. with one or more member having total income exceeding the basic exemption limit i.e. Rs. 15,000. But a H.U.F. with no member having a taxable income exceeding, Rs. 15,000 would continue to be taxed at the same rates as are applicable to individuals. Since the incidence of tax depends upon residential status, the liability of the H.U.F. to tax in India would have to be ascertained on the basis of its residential status determined within the meaning of Section 6(2) and (6). For purposes of assessment it is not necessary to find out how the joint Hindu family is constituted and how the income of the Hindu undivided family is enjoyed by the individual members thereof. The individual members, of course, would also be liable to tax in their individual capacity on their own total income. In computing their total income no account is to be taken of the income which they, as members, have received from the joint family [Section 10(2)]

A Hindu undivided family having at any time during the previous year at least one member whose total income of the previous year relevant to the assessment year 1984-85 exceed Rs. 15,000 would be chargeable to tax at the rates given below :

Income	*Rates of tax*
(1) Where the total income does not exceed Rs. 8000.	Nil
(2) Where the total income exceeds Rs. 8,000 but does not exceed Rs. 15,000.	22 per cent of the amount by which the total income exceeds Rs. 8,000 ;
(3) Where the total income exceeds Rs. 15,000 but does not exceed Rs. 20,000	Rs. 1,540 plus 27 per cent of the amount by which the total income exceeds Rs. 15,000
(4) Where the total income exceeds Rs. 20,000 but does not exceed Rs. 25,000	Rs. 2,890 plus 35 per cent of the amount by which the total income exceeds Rs. 20,000 :
(5) Where the total income exceeds Rs. 25,000 but does not exceed Rs. 30,000	Rs. 4,640 plus 40 per cent of the amount by which the total income exceeds Rs. 25,000
(6) Where the total income exceeds Rs. 30,000 but does not exceed Rs, 50,000	Rs. 6,640 plus 50 per cent of the amount by which the total income exceeds Rs. Rs. 30,000 ;
(7) Where the total income exceeds Rs, 50,000	Rs. 16,640 plus 60 per cent of the amount by which the total income exceeds Rs. 50,000 ;

Notes : 1. No income-tax shall be payable on a total income not exceeding Rs. 12,000.

2. Where the total income exceeds Rs. 12,000 but does not exceed Rs. 17,610 the income tax payable thereon shall not exceed 40 per cent of the amount by which the income exceeds Rs. 12,000.

Surcharge : Such income tax as calculated above shall be increased by a surcharge at the rate of 12.5 per cent.

Assessment year 1985-86 :

Part III of the Finance Act, 1984 which proposes the rates of tax to be deducted at source for the assessment year 1985-86 makes no change in the existing rates of tax as well as surcharge.

Assessment after partition of a Hindu Undivided Family (Section 171) :

According to this Section the total income of the family in respect of the period upto the date of partition should be assessed as if no partition had taken place and the members of the family should be held jointly and severally liable for the tax assessed on the family. For the purpose, the individual or several liability of any member or group of members of the family must be computed in accordance with the portion of the joint family property allotted to him or the group on partition. The provisions of this section—

(i) apply to all cases of partition whether total or partial and whether it is a partition of the income alone or the assets yielding the income or both ;

(ii) apply not only for the purpose of ascertaining and collecting tax but also for the purpose of levying and collecting penalty, fine or interest :

(iii) require that the I.T.O. must record a finding of a total or partial partition particularly as to the date of such partition ; and

(iv) make the members jointly and severally liable even in cases where the order recording partition is passed after the assessment on the joint family had been completed.

A total partition is one where all the assets and liabilities of family are divided amongst the members and the family ceases to exist as an undivided family. A partial partition is one where only some of the assets of the joint family are divided amongt the members and the family continues to be undivided even after partition. A partition may be partial either as regards the persons constituting the joint family or regards the properties belonging to the joint family or both. Thus a *partial partition* would be said to have taken place if—(i) only some property is divided amongst all or some of the members of the family or (ii) some member alone separates himself from the undivided family though all the assets attributable to his share may be given to him In the case of a total partition this Section deems by a fiction of law that the family continues to exist as a Hindu undivided family unless and until a finding to the contrary has been recorded by the I.T.O. Therefore, if there had been a partition amongst the members of the family on the basis of a common agreement between them, it would not necessarily mean that the family ceased to exist as undivided for income-tax purpose as well. Accordingly for all purposes of income tax, it is the order of the I.T.O recording partition which must be taken as the basis of charge in assessment and unless and until such an order of finding is recorded by the I.T.O. under the Section, the H.U.F. must continue to be assessed as undivided.

The term '*partition*' for the purposes of the Section will have to be interpreted to mean a physical division of the property of the family by meets and bounds or, where the property does not admit to physical division, such division as the property admits of. But the mere severance of status by any member or members would not amount to partition of the H U.F. whether total or partial. Therefore even if a joint family has come to an end in fact and in law but a physical division of the family property, though possible has not been effected, the I.T.O. cannot record a finding of partition and, consequently, the family would be deemed to continue as joint family. Similarly in a case where there had been a total partition and physical division of family properties, if (i) either no claim is made by any of the members of the family at the time of assessment or (ii) though a claim is made no finding is given by the I T.O. recording the partition, the family must be deemed to continue as a Hindu undivided family.

Before making an order recording the total or partial partition of H.U.F. the I.T.O. must ensure that all the following conditions are satisfied :

(i) A claim should have been made by or on behalf of any member of the

H.U.F *to the effect that a partition—total or partial*—**has taken place** amongst the members.

(ii) The claims should have been received by the I.T.O. eithe at the time of or before passing an order of regular asessment or best judgement assessment.

(iii) The family should have hitherto been assessed as undivided in respect of its income chargeable to tax under the Act.

(iv) The I.T.O. must make the necessary inquiries in the matter on the basis of the claim received by him.

(v) The I.T.O. must give notice of enquiry to all the members of the family.

(vi) The I.T.O. should be satisfied that the joint family property has been partitioned amongst the members of the family.

(vii) The partition should be one which falls within the definition of the term given above.

(viii) The date of partition stated in the claim should be the same as that ascertained by the I.T.O. on equiry. However, where the I T.O. has found that the partition had taken place on a date different from that stated in the claim the date of partition as found and recorded by that I.T.O. must be taken as the date of partition.

When once a total partition is effected and the I.T.O. has passed an order recording such a partition, the joint family constituted by some or all of the members of the disrupted joint family would be an assessable entity separate and distinct from the one which has ceased to exist. An order recording partition once passed by the I.T.O. under this Section would remain effective not only for the relevant assessment year for which it was passed but also for all subsequent assessment years and the I.T.O. must necessarily follow the order for all future assessments as well. However, the I T.O. can refuse to make an order recording partition of the H.U.F. if any condition stated above is not fulfilled, wholly or in part. The assessee cannot as a matter of right, claim from the I.T.O., an order recording partition ; but if partition has actually taken place the I.T.O. cannot ignore it for purposes of assessment ; the motive behind the partition is immaterial. The I.T.O. cannot refuse to grant an order under the Section simply because the members of the family, after partition, live together.

The term 'partition' must be construed with regard to the nature of the physical division of the family property in definite portion amongst all the members of the family is not essential ; it is enough, if, on a physical division, groups of members are allotted different properties, and in such a case the group may then hold its property as smaller joint family or tenant is common. A partition need not necessarily involve the division of the property equally amongst the members. Under partition some members may get a higher or lower share than the other and I.T.O. cannot question the basis of such a partition nor can he refuse to grant an order recording the partition on the ground that the share of member is not equal or that the partition has been effected with an open and avowed object avoiding or

reducing the burden of the tax of each member. But the I.T.O. is entitled to question the validity of the deed of portion and to call for such other total or documentary evidence as he may find necessary. The assessee has the onus of proof in regard to the fact of the partition and the validity and genuineness of the deed and other relevant matters.

This Section applies to both the schools of Hindu Law equally in so far as the term partition means only a physical division of the property in definite portions not a mere division in interest (which exists even before partition under the Dayabhaga School of Laws). As a result the procedures for assessment of a H.U.F. after its partition would be the same in the case of joint families governed by all the schools of Hindu Law. Even in cases where the property of a joint family is not divided by meets and bounds, if a separated member transfers or otherwise alienates his share in such property, the joint family cannot be assessed on the income from the alienated share in the property although an order recording partition may not have been passed by the I.T.O.

In the case of partition where a joint family has not been disrupted but only some properties have been partitioned by physical division and other not, the joint family is assessable only in respect of the income from the undivided properties. Similarly, where the members of a joint family, while remaining joint, get some of the properties of the family, partitioned amongst themselves the income from such properties shall be assessed as the income of the individual members to whom the properties were allotted. Where a share in firm, in which the Karta was a partner representing the family, is partitioned, the joint family cannot thereafter be assessed in respect of the share of income from the firm. There is nothing to restrain the member of a H.U.F., while remaining joint from entering into a partnership in respect of a business being a portion of the joint family property which had been partitioned amongst themselves. In such case the income from the business must be assessed as the income of partnership and would not form part of the joint family income. Consequently, the share of income from the firm received by each member and attributable to his divided share of the firm's assets must be assessed as his individual income. A H.U.F. may settle its business or other property upon trust under which the members of the family may be the beneficiaries. In such a case the income from such business or property forming the trust income must be assessed in the hands of the trustees as representative assessee but not in the hands of the family even if there is no partition in the family. Where a partition of all the properties of a H U.F. has not been completed on the date of assessment or by the end of the previous year, the income from properties which have not been divided physically by metes and bounds or otherwise would continue to remain the income of the joint family and, for this purpose, the family must be treated as undivided till all the assets are finally partitioned and an order recording a total partition has been passed by the I.T.O.

In respect of any partition of its income earned prior to the partition which is found to have escaped assessment a reassessment may be made on the family even after an oder recording partition had already been passed by the I.T.O in the course of the assessment proceeding of another year. For this purpose, the H U.F. would be deemed to continue to exist and the liability in respect of the tax interest, penatly or fine on such escaped income would be jointly and severally on the members of

the family. In such a case, in order to initiate the assessment proceedings it is not necessary that the notice should be served on every member of the family; it is enough if the notice is issued in the name of the joint family and served on the Karta. The same principle shall apply to the assessment proceedings against the joint family taken in the course of a regular or best judgment assessment, after its partition. But subsequent to making the assessment on the joint family, i e., after computing the total income of the family and determining the amount of tax payable thereon the amounts of tax should be apportioned amongst the members of the family on the basis of property allotted to each of them and the notice of demand must be served on each member for the amount so apportioned and payable by him. The income from property subsequent to the date of partition but upto the end of the previous year in which the partition took place must be assessed in the hands of the each member or group of members in his or its hands individually. If the partition took place after the close of the previous year, the entire income of the year shall be assessed jointly as if no partition had taken place and if the joint family was still in existence. In the case of tax payable by the family as such the members, on partition, would be jointly and severally liable in respect of the tax payable on the income although they are now divided in status. The joint and several liability of the members is personal and not negotiable in nature and is not restricted to the property received on partition. Such a liability would arise even in case where the order recording partition was passed after the assessment on the joint family had been completed.

In the case of partition of individual property converted into joint family property, or individual property gifted to the H.U.F. the assessment of the income from the converted property would be governed by the provisions of Section 64(2).

Partial partition effected after 31st December, 1978 derecognised :

Sub-section (9) of Section 171, provides that notwithstanding anything contained in the other provisions of Section 171, where any partial partition has been effected after 31st December, 1978, *in relation to a H.U.F. which has been assessed as undivided,* the following consequences would follow :

(a) It will not be competent for the I.T O to inquire into any chain of such partial partition which has taken place and no finding will be recorded under sub-section (3) of Section 171 that such partial partition had taken place.

(b) The family will continue to be liable to be assessed as H.U.F. as if no partial partition had taken place.

(c) Each member or group of members of such family immediately before such partial partition and family will be jointly and severally liable for any penalty, interest, fine or any other sum payable under this Act in respect of any period preceeding or succeeding such partial partiton.

(d) The several liability of any member or group of members will be computed in accordance with the portion of the joint family property which has been allotted to him or such group at such partial partition

The objective behind these amendments is to curb the tendency to avoid tax by creating multiple Hindu undivided families effecting partial partition as

regards persons constituting the joint family or as regards the properties belonging to the joint fomily, or both.

The Supreme Court in Kallomal T. Prasad HUF v C.I.T. 133 ITR 690 has laid down the following propositions :

1. As long as a finding is not recorded under s. 171 holding that a partial partition had taken place, the HUF should be deemed for the purpose of the Act to be the owner of the property, which is the subject matter of the partition and also the recipient of the income from such property

2 Where there is no claim that a partition total or partial had taken place, or where it is made and disallowed, an HUF which is hitherto being assessed as such will have to be assessed as such notwithstanding the fact that a partition had in fact taken place as per Hindu Law.

3. If a large number of items of property are there, they are usually apportioned on an equitable basis having regard to all the relevant factors and if necessary by asking the parties to make payments of money to equalise the shares. Such apportionment is also a kind of physical division of the properties contemplated in the Expln. to s.171.

Exemptions from tax : The exemptions and reliefs from tax which are admissible in the case of an individual in respeet of the share of income from an unregistered firm or income-tax free Government securities are also admissible in the case of a Hindu undivided family. The deduction from total income is to be claimed in respect of sums paid by the member of a Hindu undivided family on account of premium on a policy of insurance on the life of any male or female, of (minor or major) member of the family (other than a married daughter) and contributions to the Public Provident Fund. For details students may refer to the discussion on Section 80C earlier.

ASSESSMENT OF LOCAL AUTHORITY

General : The expression "local authority" has been defined not by the Income-tax Act but by Section 2(31) of the General Clauses Act. A local authority is a person under the Section 2(31) of the Income-tax Act and thus constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat, boards, port trusts, district boards and other authorities legally entitled to, or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression local authority.

Exemptions : Under Section 10(20) the income of a local authority which is chargeable to tax under the 'interest on securities', 'income from house property, 'capital gains' and 'income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service within its own jurisdiction or from the supply of water or electricity within or outside its

own jurisdictional area are totally exempt from tax. In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity, outside its jurisdictional area, *i.e.*, territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated and its residential status is governed by Section 6(4). A local authority in india is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

Tax rates: After total income, *i.e.* the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable, *i.e.*, the one prescibed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority ; for income tax purposes, local authority is chargeable to tax like a company. The effective rate of tax according to paragraph D of Part I of the First Schedule to the Finance Act, 1984, is income-tax @ 50% of the whole of its total income and surcharge @ 12½% of the amount of income-tax 1984-85 assessment year. Thus the effective rate comes to 55%.

4. ASSESSMENT OF FIRMS AND THEIR PARTNERS (Section 182 to 189) :

General Under Section 2(23) of the Income-tax Act, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who, being a minor, has been admitted to the benefits of an existing partnership. A firm, though not a legal person or a juridical entity, as chargeable to tax as a separate entity distinct from the partners and the partners are assessable as individuals and not as an association of persons or body of individuals. The term 'firm' as used in the Act covers both registered and unregistered firms. Where the firm is assessed as an unregistered firm, the levy of tax is on the firm and not on the partners. But in the case of a registered firm, the substantial levy of tax is on the partners individually. However, even in the case of an unregistered firm the I.T O. has the option to assess an individual partner without making any assessment on the firm In such cases, when once the I.T.O. has exercised this option and assessed the partners individually he cannot, thereafter, assess the same income in the hands of the firm Thus a firm is an assessee constituting a separate unit of assessment whether it is registered or not. Where a firm is registered, the registration basically affects the assessment procedure, *i e.*, computation of tax and the demand for the tax due from the firm but not the computation of its taxable income.

The residential status of a firm has to be determined depending upon the fact whether or not the control and management of its affairs is exercised from India. Even if a negligible part of the control and management is exercised from within India the firm would be resident in India for all purposes. For determining the residential status of a firm, it is immaterial to ascertain the residential status of partners thereof because a firm may be resident even in cases where all the partners are not resident in India and they control or manage the affairs from outside India. **This topic has already been discussed in detail in Study Paper I.**

Every firm is liable to pay on its total income of the previous year computed in accordance with the provisions of the Act, as are applicable to other taxable entities at the rates prescribed by the relevant Finance Act. However, there is a great deal of difference between the assessment of a registered firm and that of any other firm which to distinguish it from another, may be described as an unregistered firm. The expression "registered firm" refers to a firm registered under the provisions of clause (a) sub-section (1) of Section 185 or under the provision read with sub-section (7) of Section 184 of the Income-tax Act [Section 2(39)] and the expression "unregistered firm" in contradistinction means the one which is not so registered under these provisions.

Registration of firms (Section 184 and 185): If the partners of a firm seek registration of the firm under the Income-tax Act, 1961, they have to make an application in this behalf within the prescribed time in the prescribed form containing the prescribed particulars. A valid application for the registration of the firm can be made by or on behalf of the firm, only if it is evidenced by instrument of partnership, specifying the individual shares of profits and losses of the partners. An application for registration can be made and registration can be granted either during the existence of the firm or alter its dissolution. The application should be signed by all the partners, not being minors' personally, and in the case of firm which has been dissolved, by all the persons, not bieng minors, who were partners in the firm immediately before its dissolution and by the legal representative of any such partner who is deceased. Where any partner is absent from India or he is a lunatic or an idiot : the application for registration has to be signed by any person duly authorised by him in this behalf or as the case may be by a person entitled under law to represent him. In every case, the application for registration is to be made before the close of the previous year relevant to the assessment year in respect of which the registration is sought unless the Income-tax Officer is satisfied that the firm was prevented by sufficient cause from submitting the application with the aforesaid time limit. When an Income-tax Officer finds that the application is not in order, he shall initiate the defect to the firm giving one month's time for rectification. If the defect is not rectified within the period, he can by an order in writing, reject the application. Section 246 provides an appeal to the Appellate Assistant Commissioner against such an order.

If, on receipt of the application, for registration, the Income-tax Officer is satisfied that there is or was a genuine firm in existence constituted in the manner shown in the instrument of partnership, and that the application made is in order, he shall pass an order granting a certificate of registration under Section 184 of the Income-tax Act to the firm. If he is not so satisfied, he shall pass an order in writing refusing to register the firm.

The Income-tax Officer has got the power to refuse registration on the ground that the firm is not genuine if he finds, that a partner of the firm was. in relation to the whole or any part of his share in the income or property of the firm, at any time during the previous year, a benamidar of any partner to whom he is not related as a spouse or minor child The power is available to him with effect from 1-4-1971. In this context it may be worthwhile to note that the C B.D.T. has clarified through its circular No. 224 dated 22nd June, 1977 that in case where one of the partners in a firm is a coparcener of a H.U.F. and represents the family which is the real part-

ner in the firm, the Karta or coparcener of the family should not be regarded as a benamidar of the H.U.F. in the partnership firm.

For purposes of granting registration to a firm or for its continuation, a partnership firm should not be regarded as genuine if any partner of the firm was, in relation to the whole or any part of his share in the income of property of the partnership firm, any time during the previous year, a benamidar—

(i) of any other partner to whom he is not related as spouse or minor child; or

(ii) of any person, other than a partner of the firm, and if any of the partner knew or had reason to believe that he was such a benamidar and such knowledge or belief had not been communicated by the other partners to the Income-tax Officer.

Accordingly, if any of the partners in a firm knew or had reason to believe that one of the partners in the firm is a benamidar for any other person, such partner/s is/are stautorily required to communicate the fact to the Income tax Officer in the manner prescribed under Rule 24A of the Income-tax Rules. If such communication is not given, the partnership firm is not entitled for registration under the Income tax law. If the firm had already been granted registration, the Income-tax Officer is entitled to cancel the registration of the firm under Section 186 this is made clear in Explanation to Section 185 (1) inserted by the Taxation Laws (Amendment) Act, 1975].

When registration is granted to any firm for any assessment year, it shall have effect for every subsquent assessment year provided : (i) there is no change in the constitution of the firm or the shares of the partners as evidenced by the instrument of partnership on the basis of which the registration was granted ; and (ii) the firm furnishes, along with its return of income for the assessment year concerned, declaration to that effect in the prescribed form and verified in the prescribed manner. Such a declaration may be furnished at any time before the due date for furnishing the return. The Income-tax Officer has also been empowered to extend the time for furnishing such declaration upto the time of assessment. It has also been provided that where an Income-tax Officer finds any defect in the declaration he shall intimate the same to the assessee giving one month's time for rectification. If the defect is not rectified within a month the Income-tax Officer will declare by an order in writing that the registration granted to the firm for the earlier year shall not have effect for the subsequent assessment years. It may be noted that Section 246 provides for appeal to the Appellate Assistant Commissioner against such an order.

In cases where any change in the constitution of the firm has taken place in the previous year, the firm must apply for a fresh registration for the assessment year concerned.

Two companies can enter into a valid partnership and the Income-tax Officer cannot refuse to grant registration on the ground that the partners are companies. Where one of the partners is a minor the firm is not entitled to registration for a minor has no capacity to enter into a contract of partnership. But if a minor is only admitted to the benefits of a partnership the Income-tax Officer cannot refuse

to grant registration. If the firm has black market profits and its regular business income and the black market profits are shared by the partners in some ratio different from that specified in the partnership deed (either partly or fully), the firm would not be entitled for continuance of registration.

The Income tax authorities are not bound to register a firm under the Income-tax Act merely because the firm has been granted registration under the Partnership Act. The registration of a firm under the Income-tax Act is not a general or common law right but is a privilege given to the firms in order to enable them to get the benefits of lower rates of tax applicable to registered firms. Therefore, a firm seeking registration must fulfil all the formalities and the conditions specified under the Income-tax Act and the Rules. Illegal partnerships, *i.e.* firms constituted for carrying on any illegal business should be assessed as an association of persons. For the purpose of registration of a firm under the Income-tax Act, it is immaterial to consider whether the firm is registered under the Partnership Act or not.

Effect of registration on its tax liability : When once registration has been granted to a firm in respect of any assessment year, the firm is assessed as a registered firm.

Assessment of registered and unregistered firms : According to the Supreme Court's decision in *I T.O. v. Amritlal Bhogilal & Co. (1958) 34 I T.R. 130*, Sections 182 and 183 provide only a machinery to collect and recover tax but do not affect the computation of total income. The income of a firm thus is to be computed under each head of income in the same way, as that of any other assessee. A registered firm is assessable to income-tax in addition, the partners of every registered firm are liable, in their individual assessment, to pay income-tax in respect of their shares in the profits of the firm. In consequence, so far as the income on which tax has been paid by a registered firm is concerned, there is double taxation.

Rates of income-tax for registered firms : The rates of income-tax for registered firms and unregistered firms assessed as registered, for the assessment year 1984-85 prescribed by the Finance Act, 1984 are as under :

Income	*Rates of Tax*
I. For Professional Firms	
1. Where the income does not exceed Rs. 10,000.	Nil
2. Where the total income exceeds Rs. 10,000 but does not exceed Rs. 25,000.	4% of the amount in excess of Rs. 10,000.
3. Where the total income exceeds Rs. 25,000 but does not exceed Rs. 50,000.	Rs. 600, plus 7% of the amount in excess of Rs. 25,000.
4. Where the total income exceeds Rs. 50,000 but does not exceed Rs. 1,00,000.	Rs. 2,350 plus 13% of the amount in excess of Rs. 50,000.
5. Where the total income exceeds Rs. 1,00,000,	Rs. 8,850 plus 22% of the amount in excess of Rs. 1,000.

II. For Business Firms :

1. Where the total income does not exceed Rs. 10,000.	Nil
2. Where the total income exceeds Rs. 10,000 but does not exceed Rs. 25,000	5% of the excess over Rs. 10,000.
3. Where the total income exceeds Rs. 25,000 but does not exceed Rs. 50,000.	Rs. 750 plus 7% of the excess over Rs. 25,000.
4. Where the total income exceeds Rs. 50,000 but does not exceed Rs. 1,00,000.	Rs. 2,500 plus 15% of the excess over Rs. 50,000.
6. Where the total income exceeds Rs. 1,00,000	Rs. 10,000 plus 24% of the excess over Rs. 1,00,000.

For calculating tax a firm will be treated as a professional firm if at least 51% of its total income represents income derived from a profession carried on by the firm in all other cases it will be treated as a business firm.

Surcharge on income tax: A surcharge @ 12½% on the tax calculated at the aforesaid rates shall be payable by business as well as professional firms alike.

It may be noted that according to Section 67(1) the income-tax, if any, payable by the registered firm in respect of its total income for the relevant year is to be deducted from the firm's total income and the balance is apportioned amongst the partners to arrive at the amount of the partner's share in the income of the firm on which tax is payable by them, in their personal assessment. The deduction in respect of tax payable on total income is available even in the case of an unregistered firm which is assessed as a registered firm under Section 183(b).

Unregistered firm. An unregistered firm is assessed as a distinct unit. A partner is not entitled to any refund, rebate or deduction out of the tax paid by the unregistered firm the reason therefore being that it is a distinct assessable entity for the purposes of the Act and pays the tax in discharge of its own liability and not on behalf of its partners.

An unregistered firm is regarded as if it were an individual liable to income tax. Accordingly, the same amount of income exempt from tax, the same rates of income-tax, and surcharges thereon apply. The share a partner has in the income of an uregistered firm is includible in his total income for rate purposes but is eligible for rebate under Section 86(iii) at the average rate of tax applicable to the partner concerned. However, if the I.T.O. so chooses, he may assess an unregistered firm as if it is registered.

Unregistered firms treated as registered [Section 183(b)]: Even though no application has been made by a firm for its registration, the Income-tax Officer, instead of treating the firm an unregistered firm (in accordance with the law

discussed above), may treat it as a registered firm. However, such a practice is to be adopted by the Income-tax Officer *only if* he finds that the tax payable by the partners individually if the firm were so assessed, would be greater than the aggregate amount of the tax payable by the firm as an unregistered firm and the tax payable by the partners individually. Thus the Income-tax Officer can adopt such a course only if it is beneficial to the revenue. In such a case he can proceed to assess the firm as a registered firm and where this procedure is adopted, the firm will be liable to tax on its total income in the same manner as a registered firm and the partners will be chargeable to tax on their respective shares in the income of the firm on the footing that they were partners in a registered firm. However, for purposes of levy of interest and penalty under Section 139(8) and 271 the registered fim has to be treated as unregistered although the registration of the firm is not to be cancelled in such cases.

Computation of total income of a firm : The total income of a firm under various heads of income is computed according to the very same principles as are adopted in the case of any other taxable entity. However, while computing total income of the firm, under the head 'profits and gains of business or profession' no allowance is to be made in respect of any salary, interest, bonus, commissian or other remuneration (b t not rent) payable to any partner of the firm and the amount representing any such payments shall be added back to the profits and gains of the firm [Section 40(b)]. The total income of the firm so computed is thereafer allocated amongst the partners in their respective profits sharing ratios. The share of income of every partner so ascertained is thus having the same character as in the hands of the firm of which it is a part. However, capital gains in the hands of the firm may be treated as business income in the hands of the partner.

Computation of a partner's share income (Section 67) : It has been explained in the foregoing paragraphs how the total income of a firm is to be computed. That having been done, the next step is to determine the partner's assessable share in the income or loss of the fir n. The partner's share, whether a net profit or a net loss, shall be computed as under :

(a) Amounts paid by way of interest, salary, commission or other remuneration to the partners and where the firm is a registered firm or as an unregistered firm assessed as a registered firm, the income-tax, if any payable by the firm in respect of total income of the previous year shall be deducted from the total income of the firm and the balance as ascertained shall be apportioned amongst the partners according to their respective shares.

(b) If the balance referred to in sub-para (a) above is a positive figure, *i.e.*, profit, the partner's share of profit, in the income of the firm shall be his share in the aforesaid balance *plus* any salary, interest, commission or other remuneration paid to him by the firm in respect of the previous year.

(c) If the balance referred to in sub-para (a) is a negative figure, *i.e.*, a loss, the partner's share in the income of the firm shall be his share in the negative against which the amount of any interest, salary, commission or other remuneration paid to the partner by the firm in the previous year shall be adjusted.

(d) If the partner has paid any interest on capital borrowed by him solely and specifically for the purpose of investment in the firm itself, it shall be deducted from his share in the income of the firm assessable under the head "profits and gains of business or profession" computed in the manner provided for in parts (a) to (c).

(e) The assessable shares of the partner in the income of the firm, computed in the manner provided for in sub-paras (a) to (d), shall be apportioned under the various heads of income in the same manner and in the same proportion in which the income of the firm has been determined under each head of income.

(f) If the firm has been registered or unregistered but assessed as registered in accordance with the provisions of Section 183(b) of the Act, and the partner's share in the income of the firm, computed in the manner aforesaid, happens to be a loss, it will be set off or carried forward and set off in accordance with the provisions in force for setting off or carrying forward and setting off losses from one source against income from another source.

It must, however, be noted that where the firm has not been registered or not treated as registered under the Act, any portion of the partner's share in the profit and gains of the firm, computed In the manner discussed in the preceeding paragraphs and on which income-tax has already been paid by the firm is exempted from payment of income-tax since it has already suffered tax in the hands of the firm 86 iii). Therefore, when the unregistered firm itself has been charged to income-tax a rebate is allowed to the partner in respect of his share of income from the firm, included in his total income, at the average rate of income-tax applicable to such total income [Section 110]. In the case of a partner of an unregistered firm assessed as a registered firm the partner will be liable to pay income-tax on his share in the profits of the firm It should be noted that when an unregistered firm treated as such has a total income which is not liable to income due to smallness thereof partners do not get any exemption from tax in their own assessments in respect of their share of profits.

Illustration : AB & Co is a firm consisting of two partners A and B, both entitled to share equally the profits and gains of the partnership. It declares the following income in respect of the previous year ended 31st March, 1983.

	Rs.
Profits and gains of business remaining after	60,000
Interest paid to A	7,000
Interest paid to B	5,000
Salary paid to A	3,000
Income from property	10,000
Income from other sources	15,000
Total income of the firm	1,00,000

Partner A has separate income from house property during the previous year assassable at Rs. 10,000 and B has no other mcome.

Case 1. Assuming the firm is not registered :

Total income of the firm Rs. 1,00,000

Total Income of A

	Rs.
Income from house property	10,000
Share in the income from house property owned by the firm	5,000
Share in the income from other sources	7,500
Share of the firm's business income (30,000 + 10,000)	40,000
Total income of A	62,500

Total income of B :

	Rs.
Income from his share in the house property income of the firm	5,000
Share in the firm's income from other sources	7,000
Share of business income of the firm (30,000+5,000)	35,000
Total income of B	47,500

As the firm has not been registered, it will pay income-tax on its total income of Rs. 1,00,000 at same rates as are applicable to an individual.

Partner A will pay income-tax on only the income of Rs. 10,000 from house property at the average-tax rate of income applicable to a total income of Rs. 62,500 comprised of income from the various sources, provided that the firm has paid income-tax on its total income.

Partner B will not pay any income-tax, provided that the firm has paid the tax, as his entire income is derived from the total income of the firm which has itself suffered income tax.

Case II Assuming that the firm is registered : In this case also the total income of the firm and that of the partners A and B will be computed at the same amounts at those in the case of an unregistered firm.

As the firm has been registered, it will pay registered firm's tax (including surcharge) on a total income of Rs. 1,00,000 amounting to Rs. 11,000, (assessment year 1983-84 will be deducted together with the interest, salary, bonus, or commission from the total income of the firm and then the balance will be apportioned amongst the partners of firm in accordance with Section 67.

Set-off and carry forward of losses in the case of firms and their partners General Provisions (Section 70 to 73 and 75 to 77) : Whether a firm is registered or unregistered under the Income-tax Act, its loss under any head or heads of income with reference to any assessment year shall first be set-off against

its profits and gains under any other head of income in respect of the very same assessment year. There are only two exceptions to this general r The first is the provision under Section 74 of the Act, according to which the loss under the head "capital gains" only in respect of short-term capital assets shall be set-off against profits and gains under any other head : likewise, loss under any head of income can be set-off against capital gains arising in respect of short-term capital assets at the option of the assessee. But such a concession for set-off is not available in respect of capital losses arising from long term capital assets. The second exception to the general rule mentioned in the preceding paragraph is provided for in Section 73 of the Act. It states that any loss computed in respect of a speculation business carried on by the assessee shall not be set-off *except* against profits and gains, if any, of other speculation business carried on by the assessee.

Registered Firm

If, after having applied the above general rule, the net result of computation in the case of either a *registered or an unregistered firm treated as a registered firm is a loss*, it shall be apportioned amongst the partners of the firm in their profit sharing ratio under the respective heads of income to which it is attributable and they alone shall be entitled to have the amount of the loss set-off and carried forward for being set-off (if it is a business loss) against their personal income. The registered firm itself cannot carry forward or set-off against its income of subsequent years the apportioned loss of the partner. It is also to be noted, while set-off is allowed for a loss under any head against profits under any other head with respect to the same assessment year (excluding, of course losses in sepeculative transactions and long-term capital losses), the carry forward or set off unabsorbed loss of any year is permitted only with respect to the loss arising under the head profits and gains of business of profession' and loss arising under the head 'capital gains'. It must be noted that the net business income of a partner or a firm for any assessment year is to be arrived at after taking into account the net result of the computation of the partner's individual business, income, if any, and his share in the business income to the firm. If the last-mentioned amount is a loss, it is first to be set-off against the personal income, if any, of the partner of the registered firm under any other head. If it cannot be wholly set off the unabsorbed balanced or the whole amount to set-off against the business income of the partner in the subsequent assessment years, provided that the business or profession to which the loss is originally attributable continues to be carried on by the partner either individually or in partnership in the previous year relevant to the assesment year in respect of which the set off is claimed. The carry forward and set-off of business losses would be permissible over a period of eight assessment years immediately succeeding the assessment year in respect of which the loss was originally computed. Where both unabsorbed losses of business and unabsorbed depreciation are carried forward in the matter of set-off, preference is given to business losses, since unabsorbed depreciation can be carried forward indefinitely.

Unregistered Firm :

Where the firm has neither been registered nor treated as registered, the loss of the firm finally resulting to it, after applying the general rule stated in the first paragraph above, shall be set ff or carried forward and set off (if it is a business loss) only against the income of the firm. In other words, losses iucurred by the un-

registered firm under one head of income will first be set-off against its income under other head (excepting, of course under the head 'capital gains' or speculation business) and the balance, if it is a business loss, will be carried forward by the firm and set-off only against the business income of the firm in subsequent assessment years. It shall not be apportioned amongst the partners and no partner would be entitled to claim a set-off his share in the firm's loss against his personal income or carry forward the same even if it is a business loss as the partner of a registered firm can do. Where any of the partners dies or retires from the partnership the proportionate loss falling to the share of the retiring or deceased partner, lapse, Neither the unregistered firm nor an individual partner or even a registered firm who has retired is entitled to carry forward and set off the unabsorbed business loss against its or his income of the subsequent years to that extent. However, in cases of succession by inheritance arising from the death of a partner the successor-partner is entitled to carry forward and set-off the loss of the deceased partner and the right of set-off would not be affected.

Speculation and long term capital lossess

Losses under head 'long-term capital gains' and losses in speculation business are treated separately. Losses under any of these sources of income can be set-off only against the subsequent income from these very sources. In other words, losses under the head 'long term capital gains' must be carried forward from year to year until the profits under the very same head emerge. Such a carry forward is permissible for not more than four assessment years immediately succeeding the assessment year to which the original loss is attributable. The unabsorbed speculation losses can similarly be carried forward for a maximum period of eight years.

Change in the constitution of a firm, succession of one firm by another firm, dissolution of firm, discontinuance of business (Section 187. 188 and 189) : Sections 187 and 188 are concerned not with the computation of tax but with the person on whom the liability should be imposed. These are intended to distribute a tax already charged as between old and new partners of a firm or between the predecessor and the successor in a business.

Section 187 of the Act lays down the procedure for making assessment on a firm where, at the time of making assessment, it is discovered that a change has taken place at the time of making the assessment. In such cases the assessment must be made on the firm as *constituted at the time of making the assessment* and not constituted originally or before the change had occurred. According to the Proviso to Section 187 the firm's income of the previous year for the purpose of inclusion in the total income of the partners, shall be apportioned according to the term of partnership amongst the partners who were entitled to receive the same during the previous year The revenue however, has been empowered to recover from the firm itself, as constituted at the time of making the assessment, the unrealised tax assessed upon a partner with reference to his share of income of the firm.

Section 187 of the Act states in unambiguous terms what is meant by a change in the constitution of a firm. For purposes of income-tax, change is said to have taken place in the constitution of a firm in two cases ; firm in the case of a partner ceasing to be a partner and/or a new partner coming in, with at least one of the partners before the occurrence of the change in the firm's constitution conti-

nuing as a partner after the change and, secondly, any change in the profits sharing sharing ratio of the partners.

The Taxation Laws Amendment Act, 1984 has added a proviso to section 187 (2). Accordingly, whether a death of a partner occurs and the firm is dissolved, it will not amount to a change in the constitution of the firm. This amendment will be applicable retrospectively from 1975-76 assessment year onwards.

In the above context, unless a firm is succeeded to by any other firm (*i.e.*, unless all the partners in the predecessor firm are replaced by new partners in the successor firm) the firm will be deemed to continue its business, and the change will only be in the constitution of the firm and assessment shall be made on the firm in the manner indicated above. On the other hand, if all the old partners go out and a new band of partners comes in, it would tantamount to succession of one firm by another, and in that case the provisions of Section 188, discussed hereunder, would apply. In cases where the business of a firm is succeeded to by a limited company the firm would be taxable and the partners of the erstwhile firm would be held liable for payment of the taxes even if the partners of the erstwhile firm hold the same interest in the company as they had in the firm.

Where a succession takes place, separate assessments will have to be made on the predecessor firm and the successor firm in accordance with the provisions of Section 170. It provides that the predecessor firm shall be assessed in respect of the income of the previous year in which the succession took place, computed upto the date of succession, and the successor firm shall be assessed in respect of the income of the previous year after the date of succession. As in the case of a change in the constitution of the firm, the revenue has been empowered in the case of succession also to recover the unrealised tax payable by the predecessor firm from the successor firm not only with respect to the income of the previous year in which the succession took place upto the date of succession but also with respect to the income of the previous year immediately preceding such previous year, although the successor firm itself is entitled to recover from the predecessor any tax paid by it on behalf of the former.

Where, however, the predecessor cannot be found, both the assessment and the recovery of the tax payable with respect to the income of the aforesaid two previous years shall be made on the successor firm in a like manner and to the same extent as it would have been made on the predecessor. [Section 170 (2)]. In other words, firm B which succeeds firm A is liable to pay the unrecovered taxes of A in respect of the assessed income of A for the previous year in which the succession took place and for the immediately preceeding year in the same manner and to the same extent as A would have been liable.

The third situation that may well arise in the case of a firm, there is neither any change in the constitution nor any succession. This will arise whether either any business or profession carried on by a firm is discounted or where the firm itself is dissolved. For such cases Section 189 provides that an assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provision relating to the levy of penalty or any other sum chargeable shall apply, so far as may be, to such assessment ; and consequently every person who was a partner of the firm at the time of the discontinuance of the business or its dissolution and the legal repre-

sentative of any such deceased partner shall be jointly and severally liable for the amount of the penalty on any other sum. Where the discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced the proceedings may be continued against any partner who was, at the time of such discontinuance or dissolution, a partner of the firm or against any legal representative of such deceased partner from the stage at which the proceeding stood at the time of such discontinuance or dissolution.

Section 189(1) provides that the proceedings may be commenced and/or continued against the firm which has been dissolved or which discontinued its business as if the dissolution or discontinuance had not taken place. Thus, by a fiction of law, the firm is deemed to continue even after the discontinuance of dissolution for purposes of assessment, levy of any tax, interest, penalty or fine and also for the recovery all sums chargeable under the Act.

The Section further provides that every person, who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of the deceased partner would be jointly and severally liable for the amount of tax payable. Thus the entire tax due by the firm may even be recovered from one partner. Such a liability is not confined to tax assessed after the discontinuance or dissolution. It extends also to the tax which the firm would have been liable to pay but for the discontinuance or dissolution and the tax either found to be due already or which may become due in future. It thus includes taxes which have been assessed before the firm was dissolved and those which would be assessed thereafter. The liability of each such partner cannot also be confined to the assets of the firm falling to his share or the partner's interest or share therein.

The Explanation to sub-section (3) of Section 189 of the Income-tax Act in order to cover the liability of the partner for the tax payable on their shares of the profits of a dissolved firm to the extent the amount is necessary to cover the tax that could or should have been retained by the firm under Section 182 (4) but not actually been retained. It may be noted that under Section 184(2) a registered firm entitled to retain, out of the share of income of the partner concerned, a sum not exceeding 30% thereof, until such time the partner concerned makes payment of the tax attributable to the income. Where the tax on the share of income from the firm leviable on the partner cannot be recovered from him, whether wholly or in part the firm is liable to pay the tax of the partner to the extent of the amount which has been retained or could have been retained. Therefore, under the Explanation the partners of a dissolved firm would be liable to pay the liability of each partner of the firm in respect of his share of the income from the firm before the dissolution, to the extent of 30% of the share of each partner's income from the firm.

It may also be observed from a close analysis of all the above provisions that whether there is a dissolution or succession or merely a change in the constitution of firm, the liability due to non-recovery of tax from any one partner of the firm falls to a smaller or greater extent on the firm as such as on the remaining partners, the only exception being the one in which a firm succeeded to by another firm and one of the partners of the firm succeeded is in default of payment of tax and not the firm itself in which case the liability for payment would not be that of the succeeding firm.

Non-resident partner: Where a partner of a registered firm is not resident in India within the meaning of Section 6, the tax payable in respect of his share of the firm's profits is to be levied on and is payable by the firm itself. The amount of tax will have to be calculated at the rates applicable to the partner as if the assessments were made on the partner personally. A non-resident of a registered firm is not entitled to any exemption from his total income in respect of a proportion of his share of the firm's income corresponding to the portion of the firm's income which accrued or arose to it outside India. [Section 182(3)].

Registered firm's liability in respect of the tax payable by the partner: A registered firm must retain out of the share of each partner in the firm's income a sum not exceeding 30% thereof until partner has paid the tax in respect of share of profit of the firm. If the partner commits any default in paying the tax, the firm is liable to pay the tax to the extent of the amount which the firm is entitled to retain, irrespective of the fact whether the firm has in fact retained any amount or not. This provision applies as well to unregistered firms which are treated as registered. [Section 182(4)].

ASSESSMENT OF AN ASSOCIATION OF PERSONS OR A BODY OF INDIVIDUALS

General: Section 2(31) defines 'person' as including 'association of person's or a 'body of individuals'. The expression "association of persons' is to be understood in its ordinary sense, meaning thereby a group of congregation of persons. The expression 'association of persons' is of a wider connection and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a combination of persons formed for the promotion of an enterprise or when co-adventures join together in common action they are assessable as an association of persons provided that they do not, in law constitute a partnership. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will. But determining whether a group of persons constitutes an association of persons or not it is immaterial to consider whether or not the association—

(i) is appointed by the Court (as in the case of joint receivers);

(ii) carries on a bnsiness under a scheme evolved and controlled by the Government or any authorised authority;

(iii) is necessitated by quota regulations or other policies of the Government.

In order to constitute an association of persons, the members thereof must join in a common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own efforts in common. For this reason, the mere appointment of a common agent, manager or lessee will not make the owners assessable as an association of persons. Thus where the income does not arise to the group of members from any joint venture or joint activities, the group of persons cannot be assessed as an association of persons. The most important features of an association of persons are that (i) the

number of members is not restricted ; and (ii) the shares of each member or group of members is not definite and ascertainable. Thus co-owners, co-legatees and joint receivers joining for a common purpose or action would be assessable as an association of persons.

For instance, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator the business must be regarded as a single business assessable and in the hands of an association of persons. However, Section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that Section where the shares of the co-owners in respect of income from house property are definite and ascertainable the co-owners must be assessed not as an association of persons but individually even if the property may be owned, managed and developed jointly by the co-owners. Thus, in all cases where the share of each member in group of members is definite and precisely ascertainable, the assessment cannot be made as an association of persons.

For purposes of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in a Court of law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way effect its liability to tax or its chargeability as unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question where there is an association of persons or not depends upon the facts and circumstances of each case.

The residental status of an association of persons and consequently its tax liability are to be determined in the same way as in the case of H.U.F., or a firm. It may be noted that any amount paid to a member of an association of persons is not disallowable in determining the business income of the association since there is no specific provision in Section 40 of the Act as regards disallowance of payments to a member as it is in the case of a company or firm. A member of an association who advances monies to the association is in the status of a creditor and the interest paid or payable to him on the loan is a legitimate deduction in computing the business income of the association. A society registered under the Societies Registration Act is an association of persons for purpose of income-tax. But by virtue of the provisions of the Societies Registration Act, the tax levied is effectively on the members. Therefore, so long as the society is not dissolved or its business discontinued, the members will not be assessed in respect of the income of the society in their individual assessment nor will they be liable to pay the tax assessed on the society.

Assessment : In the case of an association the Department has got discretion or option to assess the tax either entirely on the association itself as an independent unit of assessment or on the members of the association as individual in respect of their shares in the association. Especially in cases where individual incomes of the members are high, it would be beneficial for the revenue to assess the shares of the members in their hands so that the tax collected would be greater than the amount of tax which would otherwise be collected if the income is assessed collectively in the hands of the association as was held in *C.I.T.* v. *Kanpur Coal Syndicate (1964) 53 I.T.R. 255 (S.C)*. This option, given to the Department in

the interest of the revenue, though valid and constitutional, is to be exercised judiciously. The function of exercising this option by the I.T.O. is quasi-judicial in nature and his decision in this regard is appealable. However, t' I.T.O cannot assess the same income in the hands of both the association and ... members nor can he change the assessment once made except under directions on appeal.

There is a judicial controversy regarding the issue as to whether under the Income-tax Act, 1961, in a case where an association of persons is taxed in respect of its income whether the same income could be charged again in the hands of the members individually and vice-versa. As per one view, if any one or more members of the association had been taxed on his or their share income from the association, the ITO cannot assess the total income of the association in the hands of the association subsequently (*C.I T.* v. *Blue Mountain Engineering Corporation (1978) 112 ITR 839 (Mad), Universal Commercial Coy* v. *CIT (1981) 130 ITR 775, Ch. Atchaiah* v. *ITO (1979) 116 ITR 675 (AP), Pure Nchitipur Colliery Coy (1975) 101 ITR 79 (Pat) CIT* v. *C. Ratan & Co. & S. N. Agarwalla (1981) 128 ITR 39 (Cal).*

As per the contrary view, no such option of election between the taxable units *viz* association of persons or individuals—has been given to the ITO and therefore there is no bar under the 1961 Act against assessing an association of persons even though its members have already been assessed separately in respective shares of the income of the association for the same assessment year (*Punjab Cloth Stores* v. *CIT (1980) 121 ITR 605) (Del)* ; *M K. Dhar* v. *CIT (1982) 138 ITR 801 (All).*

Thus the controversy centres round the issue as to whether under the 1961 Act, the Department has the option to tax either association of persons as a unit of assessment or the members of the AOP individually. The consensus of judicial opinion favours the view that the option continues to be available under the 1961 Act also and the tax could be levied on either of the two entities but not on both. The same income cannot be taxed twice, once in the hands of the association and again in the hands of the member. The duty of the ITO is to administer the provisions of the Act in the interests of public revenue and to prevent evasion or escapement of tax legitimately due to the State [*M.M. Ipoh* v. *CIT (1968) 67 ITR (106) SC*].

In any case, Section 86 (v) clearly provides that once the income is taxed in the hands of the association, then no tax would again be payable by the individual member in respect of the portion of the amount which he is entitled to receive from the association. The Allahabad High Court held in M K. Dhar v. CIT (1982) 138 ITR 801 that Section 86 (v) will have no application to the reverse circumstance, where after having taxed the respective shares of individual members of an association in their individual hands assessment is completed taxing the income in the hands of the association itself. However, in such cases. as pointed out by the Delhi High Court in the case of Punjab Cloth Stores, relief in respect of avoiding double taxation in the case of individual members of the association could be had by recourse to the provisions pf Section 155. On completion of the assessment of the income in the hands of the association the earlier assessment of its members could be rectified under Section 155.

In this connection students should note that as per circular F. No. 75/19/191/62-11-J issued on August 24, 1966, by the CBDT, which is binding on the I.T.

Department, the effect of the decision of the Supreme Court in CIT v. Murlidhar Jhawar and Purna Ginning and Pressing Factory (1966) 60 ITR 95 is that once the assessment of a partner of a firm or a member of an association of persons has been made by taxing directly his proportionate share from the firm or association, the ITO is precluded from assessing the firm in the status of an unregistered firm or an association of persons. Accordingly it was held by the Bombay High Court in *CIT v. V.H. Sheth and others (1984) 143 ITR 169* that once the assessment of a partner of a member of an association has been made by taxing directly his proportionate share from the firm or association the ITO is precluded from assessing the firm in the status of an unregistered firm or an association of persons.

Rebate allowable to members : A member of an association of persons or body of individuals is entitled to an exemption by way of rebate under Section 86 (v) in respect of that portion of the amount of income which he is entitled to receive from the association of persons or body of individuals. The rebate is granted subject to the conditions that—(i) the income in respect of which rebate is claimed has been subjected to tax in the hands of the association or body, (ii) the tax thereon has already been paid by the association or body. The rebate is given at the average rate of income-tax applicable to the assessee-member but the entire amount of the income from association or body must be included in his total income.

Taxation of A.O.P. where the shares of members are unknown or indeterminate : It has been found that the provisions relating to the assessment of the association of persons were misused by certain persons by forming association of persons without specifying the shares of members constituting it. *The modus operandi* in such cases is that an assessee with a high income creates a large number of association of persons with each of them declaring a small part of what in reality is the income of the assessee. Under this device, no part of the income of the association of persons is liable to be included in the assessment of its members even for rate purposes, since the shares of the members are left unspecified and care is taken to ensure that the members do not receive any income during the life of the association of persons Accordingly, income tax is payable only by the association of persons on its income which may or may not be liable to tax since it is, in the generality of cases, below the exemption limit. The net result of this arrangement is that the assessee who is in fact entitled to receive such income and who diverts such income to the association of persons as a whole pays only a very small fraction of the tax that is due from him.

In order to counteract such attempts at tax avoidance through the creation of multiple associations of persons without defining the shares of the members Section 167 A in the Income-tax Act provides that where the share of the members of an association of person (not being a company or a co-operative society) in the income of such association are indeterminate or unknown, tax shall be charged on the total income of such association at the maximum marginal rate. For this purpose, the expression "maximum marginal rate" means the rate of income tax (including surcharge on income-tax, if any) applicable in relation to the highest slab income in the case of an association of persons as specified in the finance Act of the relevant year. Sub-section (2) of Section 167A provides that where the individual shares of the members of such association of persons *in any part* of the income of such association are indeterminate or unknown, the income tax payable by the association shall be the aggregate of—

(i) the amount of income-tax calculated on the part of such total income in

which the shares of the members are indeterminate or unknown, at the maximum marginal rate ; and

(ii) in relation to the balance amount of its total income in which the shares of the members are determinate or unknown, association will be chargeable to tax at the rates at which it would have been chargeable had such remaining part of the total income been its total income, For this purpose, it has been laid down that *the share of the members in the income shall be regarded as indeterminate or unknown if such shares are not ascertainable on the date of the formation of the association or at any time thereafter.*

Explanation to Clause (v) of Section 86 provides that in the case of an association of persons which is assessable under Section 167A, each of the members of the association whose share in the income : or part of the income of such association is indeterminate or unknown will *for the purposes of determining the rate of income-tax applicable on the income of the member of the association*, be deemed to be entitled to receive an equal share in the total income or part of such total income or the part of the total income of the association and the individual share of such members in the total income or the part of the total income of the association will be determined accordingly.

These effect of the aforesaid provisions will be as follows :

(i) Where the shares of members of an association of persons in the whole of its income are indeterminate or unknown, the association will be chargeable to income-tax at the maximum marginal rate on its entire income. Further, for the purpose of determining the rate of income-tax to be applied to the income of a member of such association, every member will be deemed to be entitled to receive an equal share in the total of the association and the amount of income so determined will be included in his assessment *for rate purposes*

(ii) Where the shares of members of an association of persons of only a part of its income are indeterminate or unknown, the association will be chargeable to income-tax at the maximum marginal rate in respect of such part while the balance of its income in which the shares of the members are specific will be chargeable at the normal rates. Further, for purpose of determining the rate of income-tax to be applied to the income of a member of such association, every member will be deemed to be entitled to receive an equal share in that part of the total income of the association in which the shares of the members are indeterminate or unknown and the amount of the share so determined, as increased by the share or the member in that part of the income of the association in which the shares of member are specified, will be included in the assessment of the members *for rate purposes.*

Special Deduction in the case of certain associations : With a view to encouraging trade, professional or other similar associations, Section 44A of the Act provides for a special deduction in the cases of such association in computing their business income According to this Section the amount of any deficit, *i.e.*, the excess of expenditure incurred for the advancement of the common interest of the association concerned over the receipt from members will be allowed as deduction from the assessable income of the association from its business subject, however, to

a maximum 50% of the total income. In order to claim this deduction, the association must satisfy the following conditions :

(i) The institution should be one which is not entitled to total exemption in respect of its income under Section 10 (23A).

(ii) The association should not distribute the whole or any part of its income to its members except as grants to affiliated associations.

(iii) The income of the association during the previous year received from its members by way of subscriptions otherwise (other than remuneration received for specific services rendered to the members) must fall short of the expenditure incurred by the association solely for the purposes of protection or advancement of the common interest of its members.

(iv) The expenditure incurred by the association should not be in the nature of a capital expenditure nor one allowable under any other provision of the Act.

The amount of deficiency shall be allowed as a deduction first from its income from business or profession and then from its income under any other head of income in the same year. The amount of deficiency which is not so set off by way of deduction in the same year can be carried forward and set off in the next year.

Body of Individuals : The word 'body' would require an association for some common purpose or for a common cause or there must be unit under some common tie or occupation. A mere collection of individuals without a common tie or common aim cannot be taken to be body of individual falling within Section 2(31).

The two units, namely, an association of persons and body of individuals, cannot be identical in conception However, it is not possible to state precisely what combination would constitute an association of persons and what a body of individuals.

In *Deccan Wine an General Stores, 106 ITR III,* the Andhra Pradesh High Court observed as follows : "The expression 'body of individuals' should receive a wide interpretation, perhaps, not wide enough to include a combination of individuals who merely receive income jointly without anything further as in the case of co-heirs inheriting shares or securities, but certainly wide enough to include a combination of individuals who have a unity of interest but who are not actuated by a common design and one or more of whose members produce or help to produce income for the benefit of all. We are content to leave it at that. We will not attempt a comprehensive definition nor will we attempt to catalogue the characteristics of a body of individuals. There is danger in doing either." This passage was quoted with approval by the Gujarat High Court in *CIT v Harivalan Tribhuvandas 106 ITR 494.*

A common purpose of a common tie, actual or potential capacity to hold properties or disposable income would be the minimum requirement of such a body of individuals The purpose or aim of such a body should in the context of I.T. Act be to produce income or hold income producing assets Thus, though a body of individuals is not identical with an association of persons, they have some similari-

ties. An association of persons may consist of non-individuals too but a body of individuals has to consist only of individuals or human beings.

Another important aspect of assessment of a body of individuals is that the ITO cannot exercise the discretion of assessing the income collectively in the hands of the body or individually in the hands of the members, whichever is more beneficial to the revenue, though such a discretion can be validly exercised in the case of an A.O P. In the case of a body of individuals also, the members of the body would be jointly and severally liable to pay tax assessed on the body on its income in the event of the body's failure to pay the same. In respect of all other matters, the assessment of a body of individuals is made on lines as that of an A.O.P.

Rates of Tax : An association of persons or a body of individuals is assessable to tax at the same rates as are applicable to individuals (explained earlier). The provisions for the levy of surchage and allowance of marginal relief would also apply in same manner as are applicable to the individuals.

ASSESSMENT OF CO-OPERATIVE SOCIETIES

General : The expression "co-operative society" means a society registered under the Co-operative Societies Act, 1912 or under any other, law for the time being in force in any State for the registration of co-operative societies. [Section 2(19)]. For purposes of taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank v. C.I.T. (1965) 57 I.T.R. 579.*

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under Section 27(iii). Accordingly, the co operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

Rates of tax : The rates of tax applicable to co-operative societies under the Finance Act, 1984 for the assessment year 1984-85 are :

Taxable income (after granting the exemptions specified in Section 80 P)

Upto Rs. 10,000	15% of the total income
Rs. 10,000 to Rs. 20,000	Rs. 1,500+25% of the excess over Rs. 10,000.
Above Rs, 20,000	Rs. 4,000+40% of the excess over Rs, 20,000

In addition to the tax calculated at the aforesaid rates surcharge @ 12½% of the tax is also payable by co-operative societies.

Exemptions : 1. The income of a marketing society derived from the letting out of godown or warehouses for storage, processing or facilitating the marketing of commodities is totally exempt from tax under Section 10(29).

2 Section 80P provides certain exemptions to co-operative societies. Students may refer to the detailed discussion of this provision, under deductions from gross total income

3. Dividends received from co-operative societies would be included in the categories of income eligible for exemption under Section 80L in the hands of individuals and H U.F.'s. Section 80L allows a deduction to individuals and Hindu undivided families from their gross total income upto a maximum of Rs. 7,000 (along with the other items qualifying for exemption under that Section) in respect of the following income received from the co-operative societies or from banks) :

(a) interest on debentures of co-operative societies including co-operative land mortgage banks and co operative land development banks ;

(b) interest on fixed, savings or other deposits with co-operative societies carrying on banking business including Co-operative land mortgage and land development banks.

4. A co-operative society which has established as a new industrial undertaking is not liable to pay income-tax in respect of so much of its income as does not exceed 6% per annum of the capital employed. The exemption is available for 7 years, for the year in which it commenced business and for six years next following as against 5 years for other assessees [Section 80J (2)].

Where such new industrial undertaking has begun to manufacture or produce articles on or after 1-4-81 it would be eligible for the deduction under Section 80 I in respect of 20% of profits and gains derived from such undertaking wherever the gross total income of the society includes such profits This deduction would be available for a period of 10 assessment years commencing from the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce goods.

Further, where the co-operative society is also entitled to the deductions available under Sections 80HH, 80HHA, 80I, 80J, 80JJ, and 80JJA the deduction under this section [*i e.*, 80P (I) shall be allowed with reference to the total income as reduced by the deduction allowable respectively under Sections 80HH, 80HHA, 80J, 80JJ and 80JJA.

It may also be noted that the provisions of Section 194A which require deduction of income tax at source from interest other than 'interest on securities' credited or paid, where the aggregate payment in any financial year exceeds Rs. 1,000, do not apply to cases of interest paid by co-operative banks (including co-operative land mortgage banks and co-operative land development banks) or interest paid by co-operative societies to other co-operative societies or to a member of the society on deposits made with the society.

ASSESSMENT OF MUTUAL CONCERNS

General Principles of mutuality :

(1) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in that character. The cardinal requirement in the case of a mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete indentity between the contributors and the participators.

(2) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(3) It does not make any difference whether the persons joining together from an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

(4) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association

(5) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(6) It is not necessary that the surplus should be returned to every member of the association *pro rata*. The identification between the contributors and the participators should be regarded in one whole and not in relation to each individual.

(7) It is not necessary that all the activities of such an association should be mutal in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with oneself and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances :

(1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.

(2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific services performed for its members.

(1) *Insurance business* : Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44

expressly provides that the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act.

Trade and professional association :

A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only from *specific* services rendered by an association to its members. Any surplus arising to a mutual association in other ways e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any part of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipts form the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession." If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It can be carried forward to the next year and set off against income of the relevant assessment year. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

Clubs: The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by *members* is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by *non-members* and on the income derived from its capital assets. Where a club is an incorporated company carrying on *business* it may be taxable on the money received from its members as well as non-members in the course of its business.

However, if the club is not a member's club but .. a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. This position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

Cooperative Societies : In the case of a cooperative society, the liability to tax depends upon whether (a) it is a mutual concern earning non-taxable surplus or (b) it is a non-mutual concern earning taxable profits. Irrespective of the mutual or non-mutual character, all cooperative societies are exempt from tax under section 80P subject to certain conditions. However, in the case of cooperative socteties not falling within the meaning of the definition in section 2(19) (for example, co-operative societies registered abroad), the provisions for exemption under law as discussed earlier will be applicable.

LIABILITY IN SPECIAL CASES

Legal representative :

1. **Meaning** : Section 2 (29) of the I.T. Act states that the term 'legal representative' in the Income-tax Act has the meaning assigned to it in clause (11) of Section 2 of the Code of Civil Procedure, 1908. Section 2(11) of the code of Civil Procedure provides as follows :

"Legal representative" means a person who in law represents the estate of a deceased person and includes any person who intermeddles with the estate of the deceased and where a party sues or is sued in a representative character the person on whom the estate devolves on the death of the party so suing or sued. It is not necessary that the legal representative should be the beneficial owner of the estate. Nor need he be in possession of any property of the deceased. It is sufficient that the estate devolves on him. So for as HUF is concerned it continues to exist as an assessable unit despite changes in its composition including the change of its Karta by death or otherwise and consequently there is no scope or necessity for involving this section when a Karta dies. A legal representative assessed under this section is different from a representative assessee to whom Sections 160 to 167 apply, legal representative does not fall within any of the categories of representative assessee enumerated in Section 160. Where a person leaves a will appointing executors, the executors are the legal representatives. The act expressly declares that the legal representative is deemed to be an assessee for the purpose of this Act.

Liability of legal representative : The Act imposes a liability on the legal representative not only in respect of tax but also as any other sum (penalty, fine or interest) which the deceased would have been liable to pay if he had not died. This liability is limited to the extent to which the estate is capable of meeting the liability.

Assessment on Legal Representative : This Section applies irrespective of whether the assessment proceedings has not been started, or were pending, or were completed and the assessment made, before the death of the deceased. If at the date of death of the deceased a return of income had not been made under Section 139 (1) and a notice under Section 139(2) or Section 148, as the case may be, had not been served on him, the ITO should first issue the notice under appropriate section to the legal representative of the deceased and then proceed to assess the

income of the deceased in the hands of the representative as if the representative were the assessee. If there are more legal representatives than one, the notice should be served on all of them ; but it would be sufficient if the notice is served on one or more who effectively represent the estate or who are ascertained, after diligent and bona fide inquiry by the ITO to be the legal representatives. It is obligatory upon the representative to comply with the notices appropriately served. Assessment may be made on the representative under Section 147 in respect of income of the deceased which had escaped assessment in the relevant years.

Income upto the date of death of the end of the accounting year : Students should carefully note that Section 159 applies in respect of the *income of the deceased* only upto the date of death and not upto the end of the accounting year in which the death occurs. The *income of the estate* for the period from the date of death upto the end of the accounting year in which the death occurs should be assessed under Section 168 in the hands of the Executor. Thus in respect of the year of death two separate and distinct assessments would have to be made—the prior one on the legal representative and the latter one on the 'executors' under Section 168. This may even lower the incidence of tax for the year. The position will be the same even if the 'representative' and the 'executor' are one and the same.

Apportionment : As a consequence of two separate assessments as mentioned above apportionment of income between the two periods becomes necessary. Here it is to be noted that certain incomes like dividends or interest if they become payable after the death cannot be apportioned to the period upto the date of death because they do not accrue from day to day.

Penalty on legal representative : Penalty proceedings for a default committed by the deceased can be started or continued against the legal representative. He, being an assessee, is also liable to a penalty for his own default.

Personal liability : We have noted that the liability of a legal representative is "limited to the extent to which the estate is capable of meeting the liability". However, he becomes personally liable to the extent of the value of any asset of the estate which he disposes of while the liability for tax remains undischarged. This personal liability is imposed by sub-section (4) only in respect of tax and not in respect of penalty, fine or interest.

Recovery from legal represeentiative : A legal representative must be regarded as an assessee for the purposes of recovery proceedings. A recovery certificate issued to the tax recovery officer during the life-time of the assessee may, after his death, be enforced against his legal representative without the name of the latter being substituted in the certificate. But such proceeding cannot be started against him unless he has been served with a notice of demand under Section 156. Further he is not personally liable for the tax payable by the deceased unless some assets of the deceased have come into his hands and are not properly applied or accounted for.

Representative Assessee (Section 160) : 1. **General:** Besides the legal representatives mentioned above, in certain cases, the income received by one person can be assessee in the hands of another. Persons who are liable to be assessed on behalf of others because of their association with the real recipient of the income are known as representative assessees. The expression 'representative assessee' means—

(i) the agent of a non-resident including a person who is treated as an agent under Section 163 in respect of the *income of the non-resident which is* deemed to accrue or arise to him in India ;

(ii) the guardian or a manager of a minor, a lunatic or an idiot in respect of the income of such latter person ;

(iii) the Court of Wards, Adminstrator-General, Official Trustee, Receiver or Manager appointed by or under any order of a Court in respect of the income which they received or are entitled to receive on behalf of or for the benefit of any other person ; and

(iv) a trustee appointed under a trust deed by a duly executed instrument in writing, whether, testamentary or otherwise, in respect of any income which he is entitled to receive on behalf of or for the benefit of any person ;

(v) a trustee appointed under an oral trust in respect of the income which he receives or is entitled to receive on behalf of or for the benefit of any person.

It may be noted that the last category listed above was introduced by the Finance Act, 1981 with effect from 1st April 1981. The new explanation added for the purpose of this last category makes it clear that a trust which is not declared by a duly executed instrument in writing (including a Wakf deed which is valid under the Mussalman Wakf Validating Act, 1913) will be deemed to be a trust declared by a duly executed instrument in writing if a statement in writing signed by the trustee or trustees and setting out the purpose or purposes of the trust, particulars of the trustee or trustees, the beneficiary or beneficiaries and the trust property, is prepared and forwarded to the Income-tax. Officer within the specified time-limit. Where the trust has been declared before 1st June 1981 the specified time-limit will be 1st September 1981 and in any other case, three months from date of the declaration of the trust. For this purpose, the item 'oral trust' means a trust which is not declared by a duly executed instrument in writing including any Wakf deed and which is also not deemed under the new Explanation I to be a trust declared by a duly executed instrument in writing.

2. **Liability of a Representative Assessee** (Section 161) : Every representative assessee is deemed to be an assessee under the Income-tax Act. He, therefore, has the same responsibilites, duties and liabilities as if the income were being received by him beneficially. He is liable to be assessed in his own name in respect of such income but the assessment is deemed to have been made upon him in his representative capacity. The tax is levied on and is recovered from such an assessee, in the like manner and to the same extent as it would have been levied upon and recovered from the person represented by him.

The Finance Act, 1984 has inserted a new sub-Section 1A in Section 161 with effect from 85-86 assessment year.

Accordingly where any income in respect of which the trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, including any valid wakf deed, is liable as a representative assessee consists or includes, profits and gains of business, tax shall be charged on the whole of the income in respect of such a person at the "maximum marginal rate". However this provision will not apply in cases where such profits and gains

are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such is the only trust so declared by him.

The Department has the option to make an assessment on the representative assessee or a direct assessment on the person beneficially entitled to the income. Thus, the I.T.O. may assess the agent or the non-resident; he may assess the guardian, manager, receiver or trustee or assess the beneficiary directly. Therefore, if an incapacitated person has no trustee or guardian or, if the trustee or guardian is not resident of India and cannot be found, the assessment may be made on the incapacitated person directly. But once the Department has exercised this option and assessed the representative assessee or the beneficial recipient of the income, it cannot again assess the same income, to tax in the hands of the other. The Department having assessed either of the two, has the option, to recover the tax from the property held by him or by the other. This option conferred on the Department in the interest of the Revenue has to be exercised judiciously and with reasonable care.

The provisions of Section 160 and 161 contain only a machinery to levy and collect the tax but do not, in any way, affect the incidence of tax on a certain income and the scope of total income that must be subjected to tax.

3. **Right of a Representative** Assessee. (Section 162): Every representative assessee who is charged to tax as such is entitled to recover the tax paid from the person on whose behalf he had paid it or to adjust it against any moneys in his possession. but belonging to the other persons. The representative assessee has the right to retain, out of the moneys, in his representative capacity, an amount equal to any sum paid or payable by him under the Act in addition to the right to recover the same from the beneficial owner of the income. An agent who apprehends that he may be assessed as a representative assessee has the right to retain such sum irrespective of the fact that the non-resident may turn out to be not at all assessable to tax in India when the assessment is ultimately made upon him.

4. **Statutory Agent of Non residents**: An agent is considered a representative assessee but only if he is the agent of non-resident person. According to Section 163, an agent, in relation to a non-resident person, includes any person in India :—

(i) who is employed by or on behalf of the non-resident;

(ii) who is having any business connection with the non resident;

(iii) from or through whom the non-resident is in receipt of any income, whether directly or indirectly;

(iv) who is trustee of the non-resident; and

(v) any other person who (whether resident or non-resident) has acquired a capital asset in India by means of a transfer from the non-resident

In the first four cases stated above, the person sought to be assessed as the agent of a non-resident must necessarily be in India whereas it need not be so in the fifth case. Thus, a non-resident may be treated as the agent of another non-resident. The appointment of the agent may be made at any time before or after

the expiry of the relevant previous year. An agent of a non-resident may be appointed under this Section even if at the date of such appointment the non-resident is not alive.

According to the proviso to this Section, where transactions are carried on in the ordinary course of business through a broker in India and the broker does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker the broker in India cannot be treated as a statutory agent in respect of the income arising to the non-resident from such transactions. Thus, where *bona fide* hedging transactions take place through a broker in India and a foreign broker acting for an undisclosed principal, the Indian broker cannot be deemed to be agent of the foreign principal. But generally a broker is not deemed to be the agent of a non-resident person so long as he functions exclusively in his capacity as a broker.

The agent is chargeable to tax in India as a representative assessee only in respect of the income which is deemed to accrue or arise in India to the non-resident under Section (9)(1)(i) [This has been discussed in Study Paper-1]. He is chargeable to tax in the like manner and to the same extent as the non-resident and is assessable in respect of the income of the non-resident only. The agent for being assessed under this Section need not be in receipt of the income on behalf of the non-resident in respect of which he is assessed. Thus, a person in India who has not received any income on behalf of a non-resident but has actually paid the non-resident the sums sought to be taxed (*i.e.*, interest on a loan advanced by the non-resident or dividends) may be treated as an agent under this Section. The agents liability is personal and, therefore, cannot be negotiated ; this liability is not also conditional to take effect upon his having funds of the non-resident. If the agent is not able to recover from the non-resident the amount of tax, he cannot claim it as a bad debt or a loss or an expense incidental to the business. There is no provision in the Act for recovering the tax from his personal assets, where the assessment is made directly on the non-resident's agent though the Department is entitled to proceed against the non resident's property in the possession of the agent.

Statutory Agent : With a view to avoiding the difficulties which may arise in cases, where there is no agent in India in whose hands the income deemed to accrue or arise in India to a non-resident may be assessed, this Section empowers the I.T.O. to appoint a statutory agent. The person deemed to be an agent under this Section may not be an agent at all in fact and in law. Thus, any person who is statutorily appointed as the agent is deemed to be an a agent for income-tax purpose. But a person appointed by the I.T.O. as an agent need not necessarily be assessable as a representative assessee in respect of the non-resident's income. For instance, though there may be a business connection between a resident and non-resident company, where there is no evidence to prove that any profits accrued to the non-resident company through the business connection, no assessment can be made on the resident company as the agent of the non-resident company : the mere appointment of the resident company as the agent of the non-resident company would be of no avail for this purpose.

In order to be assessed as an agent the agent must have some direct or indirect connection or concern with the income of the non-resident sought to be assessed in his hands. The liability of an agent under this Section also covers the liability to advance tax and deduction of tax at source. Before a person can be treated as an

agent of a non-resident he must be given a reasonable opportunity of being heard by the Income-tax Officer as to his liability to be so treated.

Under Sections 160 and 161, the Department has the option to make an assessment on the representative assessee or a direct assessment on the person who is beneficially entitled to the income. Therefore, if the time-limit of two years specified in Section 149 (3) has expired, the I.T.O. would not be entitled to issue notice to the agent of the non-resident to assess the income of the later ; but in such cases the I.T.O. may make direct assessment on the non-resident since no time-limit has been specified for this purpose. Further, under Sections 166 and 167 the Department has two options *viz.* (i) to assess the representative assessee or the non-resident, and (ii) having assessed either of the two to recover the tax from the property held by him or by the other. Thus where the time-limits for assessment on the agent have expired, the assessment may be made on non-resident and tax may be recovered from the agent since there is no time-limit for recovery of the tax due from a non-resident.

Taxation of Discretionary Trusts [Section 164 (1)] : Section 164 deals with taxation of trustees of a discretionary trust. This Section applies in the case of a representative assessee referred to in clause (iii) or clause (iv) of sub-section (1) of Section 160 in a case where any income or part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown.

The representative assessee referred to in clauses (iii) and (iv) of Section 160 (1) are the Court of Wards, the Administrator General, the Official Trustee or any receiver or manager including any person whatever his designation who in fact manages the property on behalf of another, appointed by or under any order of a court and a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise (including any Wakf Validating Act 1913).

Such a discretionary trust will be liable to tax at the *maximum marginal rate of income-tax* (including surcharge) on their entire income. Thus, the entire income of a discretionary trust will be liable to tax for the assessment year 1984-85 at the rate of 61·875 per cent (55% income tax plus 6.875% surcharge).

With a view to obviating hardship in genuine cases where the circumstances are such that tax evasion could not be considered to be main purpose of creating a trust, certain exceptions have been specified where the trust would not be taxed at the maximum marginal rate. The exceptions are as under :—

(1) Where none of the beneficiaries has any other income chargeable to tax or is a beneficiary under any other private trust. In this context, the expression, income chargeable to tax would mean total income above the exemption limit for the relevant assessment year. Thus the income of a discretionary trust will be chargeable to tax at the maximum marginal rate in cases where any of the beneficiaries has any other taxable income exceeding the exemption limit or if any of the beneficiaries is a beneficiary under any other private trust.

(2) Where the discretionary trust is created under a will and such trust is the *only* trust so created under the will.

(3) In case of a discretionary trust created *prior to 1.3.70.* by a non-testamentary instrument if the I.T.O. is satisfied that the trust was so created *bona fide* exclusively for benefit of the dependent relatives of settlor or where the settlor is a H.U.F. for the benefit of the members of such families in circumstances where such relatives or members are mainly dependant on the settlor for their support and maintenance.

(4) In cases where the income is receivable by the trustee on behalf of provident fund, superannuation fund, gratuity fund, pension fund or any other fund created *bona fide* by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or professions.

In the above 4 cases the income of the trustees will be taxed not at the marginal rate but at the rate applicable to the income of an association of persons.

The Finance Act, 1984 has inserted a second proviso to Section 164 (1) with effect from 85-86 assessment year.

Accordingly where any income in respect of which a trustee appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise, is liable as a representative assessee consists of or includes profits and gains of business, the above concessional treatment i.e. assessing the income at the rate applicable to an AOP will apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

For the purposes of these provisions a trust under which a discretionary power is given to the trustees to decide the allocation of the income every year or a right is given to the beneficiary to exercise the option to receive the income or not each year will all be regarded as discretionary trusts and assessed accordingly. This is made clear in Explanation 1 to Section 164 which provides as under :—

(a) Any income in respect of which the Court of Wards, the Administrator-General, the Official Trustee, receiver, manager, trustee or mutawalli appointed under a wakf deed is liable as a representative assessee or any part thereof shall be regarded as not being specifically receivable on behalf or for the benefit of any person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the Court or the instruments of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed. For this purpose, it is not necessary that the beneficiary in the relevant previous year should be actually named in the order of the court or the instrument of trust or wakf deed, all that is necessary is that the beneficiary should be identifiable with reference to the order of the court or the instrument of trust or wakf deed on the date of such order instrument or deed.

(b) The individual shares of the persons on whose behalf or for whose benefit such income or part thereof is receivable will be regarded as indeterminate or unknown unless the individual shares of such persons are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

This Explanation seeks to prevent trustees and beneficiaries from manipulating the arrangements in such a manner that a discretionary trust is converted into

a specific trust whenever it suits them tax-wise.

Income from property held under trust wholly for Charitable or Religious purposes [Section 164 (2)] : In case the income, in respect of which the shares of the beneficiaries are indeterminate or unknown, is derived from property held under trust *wholly* for charitable or religious purpose or which is of the nature referred to in Section 2 (24) (iia)—voluntary contributions received by a trust or which is of the nature referred to in sub-section 4A of Section 11 (business income received by a trust)—the tax shall be charged on so much of the income as is not exempt under Section 11 or 12 as if the income not so exempt were the income of an association of persons.

The Finance Act, 1984 has inserted a new proviso to Section 164 (2) with effect from 85 86 assessment year. Accordingly where the whole or any part of the relevant income is not exempt under section 11 or Section 12 because any income thereof ensures to the benefit of prohibited persons or the rules with regard to investments in specified channels have not been followed tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

Income from property held under trust partly for religious purposes and partly for other purposes [Section 164 (3)] : If property held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes is not known. With effect from the assessment year 1980-81 the tax liability will be the aggregate of the following :—

(a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under Section (11) as if such part (or such part so reduced) were the total income of an association of persons ; and

(b) the tax on that part of income which is applicable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate i.e. 66 per cent for the assessment year 1981-82.

However, in the following cases, income will be charged to tax as if it were income of an association of persons :

(a) where none of the beneficiaries has any other income chargeable to tax i.e. income should not exceed the maximum amount not chargeable to income-tax none of the beneficiaries is a beneficiary under any other private trust ; or

(b) where the trust is created by will and such trust is the only trust so declared by him; and

(c) where the trust is a non-testamentary one created before March 1, 1970 for the exclusive benefit (to the extent it is not utilised for charitable or religious purposes) of relatives of the settlor mainly dependent on the settlor for their support or maintenance or where settlor is a Hindu undivided family, for the exclusive benefit of its members so dependent upon it.

The Finance Act, 1984 has inserted two additional provisos to Section 164 (3) with effect from 85-86 assessment year. Accordingly

(1) Where the relevant income consists of or includes profits and gains of business, the preceding concessional method of taxation shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust so declared by him.

(2) Where the whole or any part of the relevant income is not exempt under Section 11 or Section 12 because any income thereof ensures to the benefit of prohibited persons or the rules with regard to investment in specified channels have not been followed, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate

Taxation of oral Trusts [Section 164A]: Under this provision, any income which a trustee receives or is entitled to receive on behalf of or for the benefit of any person under an *oral trust* will be chargeable to income tax at the maximum marginal rates. For this purpose the expression 'maximum marginal rate is the rate of income-tax including surcharge of income-tax applicable in relation to the highest slab of income in the case of an association of persons as specified in the Finance Act of the relevant year. As a result of this provision an oral trust, the terms whereof are not subsequently recorded in writing and intimated to the Income-tax Officer in the specified manner, will be chargeable to income-tax at the maximum marginal rate in all cases. However, if the terms of an oral trust are subsequently recorded in writing and intimated to the Income-tax Officer in the specified manner the income will be chargeable to tax at the maximum marginal rate only in those cases where the shares of the beneficiaries are indeterminate and unknown. Where, however; such shares are determinate or known the tax will be levied and recovered from tne trustees in the same manner and to the same extent as would be leviable or recoverable from the beneficiaries.

Cases where part of trust income is chargeable: Section 165 provides that in cases where only some portion of the trust income to which the beneficiary or beneficiaries is/are entitled is taxable and the other portion is not taxable, the taxable portion of the income received by him from the trust as a beneficiary shall be only such portion thereof as bears to the whole portion the ratio which the taxable portion of the income of the trust bears to the whole income of the trust. In other words, where a part only of the trust income is chargeable to tax under this Act, the beneficiaries' share of the income should be taken to be that derived proportionately from the chargeable and non-chargeable portions of the trust income and should be assessed accordingly in the hands of the trustee/s.

It may be worthwhile to mention here that every representative assessee is regarded in law as an assessee for all the purposes of the Income-tax Act and is subject to the same duties, responsibilities and liabilities, as if the income were received by or accruing to or in favour of him beneficially and is thus liable to assessment in his own name in respect of the income. It has also been specifically provided that a representative assessee shall not be assessed under any other provisions of the Act in respect of any income relating to which he is representative assessee except in his representative capacity as provided for in Section 161 of the Act. A protection has been given to the representative assessee with regard to the recovery of the tax paid by him, if any, on behalf of a beneficiary

as regards the income in respect of which he is a representative assessee. Provision has also been made for the representative assessee to obtain a certificate from the Income-tax Office stating the amount which the representative assessee is entitled to retain for the final settlement of the liability.

Multiple association of persons where shares of members are unknown (Section 167A): Section 167A has been introduced with a view to counteracting attempt at tax avoidance through the creation of multiple association of persons without defining the shares of members. Under this provision, where the shares of members of an association of persons (not being a company or a cooperative society) in the income of such association are indeterminate or unknown, the tax shall be charged on the total income of such association at the maximum marginal rate. For this purpose, the expression 'maximum marginal rate' means the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of Income in the case of association of persons as per the Finance Act of the relevant year.

Sub-section (2) of Se tion 167A provides that where the individual shares of the members of such association of persons in any part of the income of such association are indeterminate or unknown, the income-tax payable to such association of persons shall be the aggregate of :—

(a) the amount of income-tax calculated on the part of such total income in which the shares of the members are indeterminate or unknown, at the maximum marginal rate : and

(b) in relation to the balance amount of certain income which the shares of the members are determinate or unknown, the association would be chargeable to tax on the remaining part of the total income if it were its total income. Thus, where the shares of members of an association of persons are indeterminate or unknown, the association will be chargeable to income-tax at the maximum marginal rate in respect of such part while the balance of its income in which the shares of the members are specific will be chargeable at the normal rates.

For the purpose of this provision, the shares of members in the income shall be regarded as indeterminate or unknown if such shares are indeterminate or unknown on the date of the formation of such an association or at any time thereafter.

It may be recalled that the Finance Act 1981 had also added an Explanation to Section 86 (v) to provide that in the case of an association of persons which is assessable under this Section, each of the members of the association whose shares in the income or part of the income of such an association is indeterminate or unknown will for the purposes of determining the rate of income-tax applicable on the income of the members of the associations be deemed to be entitled to receive *an equal share* in the total income or part of such income of the association and the individual share of such members in the total income or part of the total income of the association will be determined accordingly.

Executors and Administrators (Sections 168 and 169) : Where executors and administrators or other persons have been appointed to administer the estate of a deceased, the income arising from such an estate shall be chargeable to tax in the

hands of the executor or executors, as the case may be. If there is one executor, the assessment shall be made on him in the statı ›f an individual. If on the other hand, there are more executors than one, then tne assessment will be made *on them in the status of an association of persons.* Separate assessment shall be made on the executor or executors on the total income of each completed previous year or part thereof as is included in the period from the date of death of the deceased to the complete distribution to the beneficiaries of the estate according to their several interests. Any income of the estate of any previous year which is distributed or applied to the benefit of any specific (but not residuary) legatee of the estate during that previous year shall be excluded from the computation of the total income of that previous year assessed in the hands of the executors. The income so excluded shall, however, be included in the total income of the previous year of the 'specific legattee' himself.

Where the executors apply a portion of the income received by them from the estate in a particular way pursuant to the directors of the testator or other legal obligations, it is merely an application of income and would not entitle the executors to claim any deduction in respect of the income so applied. Thus, payment of the cost of the probate, death duties and other debts due to the State or periodic payments to the beneficiaries (other than the specific legatees) out of the property of the testator or to a Court caunot be excluded in computing the executor's chargeable income from the estate.

Under the general law when an executor gives his assent to a specific legacy, the title of the legatee relates back to the date of death and consequently the income arising after the death and before the asset belong to the legatee is taxable in his hands but not as the income of the executor. However, it is only the income distributed to or applied for the benefit of any specific legatee during the previous year which should be excluded from the executors' total income. In other words, if the income is not so distributed or applied in the previous year, it would be taxable as part of the income of the executor. If the executor is also the sole beneficiary it does not necessarily follow that he receives the income in the latter capacity.

If the legatee is a *residuary* legatee, the income from the residue is the income of the executor taxable in his hands so long as the estate has not been completely administered ; it is only after the estate is fully administered and the net residue is ascertained that the residuary legatee gets a title and the income, therefore, can be said to accrue to him and can be taxed in his hands. This principle would apply irrespective of the fact whether the residue is settled in trust for a life tenant or is bequeathed absolutely and it would apply even if a part of the income of the estate had been actually paid on account to the residuary legatee pending the administration of the estate. However, the administration may be regarded as completed, the executor's assent to the residuary legacy as valid and the legaeet's title as established, although some liabilities due by the estate may remain undischarged.

According to Section 169 the rights of the executors for retention and reimbursement or for the recovery of the tax paid by them are the same as these of representative assessees under Section 162.

Liability of a Successor to Business in respect of the tax chargeable from the Predecessor (Section 170) : Where a person carrying on any business, profession,

or vocation is succeeded to by another person, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in respect of the actual share to which he is separately entitled in his income, profits and gains of the previous year. Thus, the predecessor in business would be assessable in respect of the income of the year of succession upto the date of succession while the successor would be assessable in respect of the income of that year after the date of succession. Accordingly, the income of the year in which the succession takes place is to be appointed between the predecessor and the successor with the share of each. The income must be computed separately and each must be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

However, where the predecessor cannot be found the assessment of the profits of the year on which the succession took place up to the date of succession and also of one year preceding the year of succession should be made on the successor in the like manner and to the same extent it would have been made on the predecessor. Again, if the assessment has already been made on the predecessor for either or both of the years aforesaid, but the tax due in pursuance of each assessment cannot be recovered from the predecessor or any person, it shall be payable by and recoverable from the successor. The successor, of course, shall be entitled to recover the full amount of tax paid by him from the predecessor.

Under this Section the I.T.O. is required to record a finding that the tax in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such tax from the successor. The successor's liabilities to tax arises also in respect of any gain (*e g.*, capital gains) accruing to the predecessor from the transfer of the business. The provisions of the Section do not apply to cases of succession on the death of the person carrying on a business. The successor, however, is not entitled to claim to carry forward and set off the losses incurred by his predecessor. He has no right to carry forward even the unabsorbed depreciation allowance of the years prior to his succession to the business. The predecessor also cannot carry forward his loss because the right of carry forward can be exercised only if the business which the loss was incurred is in existence and continues to be carried on by the same person.

(E) **Assessment after partition of a H U.F.** (Section 171) : The relevant provision in this regard have been discussed in Study Paper IV under the head "Assessment of a Hindu undivided family.

(F) Shipping Business of Non-residents (Section 172); For the assessment of freight earned in India by ships belonging to or chartered by a non-resident, a special mode of assessment is prescribed under the Act. Under this Section, no vessel owned by a non-resident can leave any port in India, unless the port authorities grant a tax clearance certificate. Such a certificate shall not be granted unless the master of the vessel produces a certificate from the Income-tax Authorities showing that the taxes payable have been paid or satisfactory arrangement for their payment have been made. Where the non-resident owner has an agent in India from whom tax is recoverable on a regular assessment, the Income-tax Officer, in such cases, may grant a port clearance certificate, valid for one year on receipt of an application in this behalf. If the Income-tax Officer is not satisfied that there is an agent in India who can be assessed on behalf of non-resident, he shall make a separate assessment in respect of the income of

each vessel, before ft leaves the port. Such an assessment will be made on an *ad hoc* basis and is known as "assessment on trampsteamer basis."

In such cases, 7½% of the amount paid or payable or out of India on account of carriage of passengers or goods to the owner or charterer, is deemed to be his income accruing in India in respect of the carriage. The income of the non residents from shipping business must be computed under Section 44B explained in Study III.

It is the responsiblity of the master of the ship to prepare and furnish to the Income-tax Officer a return of the full amounts paid or payable to the owner or the charterer, on account of the carriage of goods or passengers. On receipt of such a return the Income-tax Officer assessees the income and determines the amount of tax payable thereon, at the rates applicable to a company which has not made the prescribed arrangement for the declaration and payment of dividends within India. This sum is payable by the master of the ship.

After the close of the previous year it is permissible for a non-resident person on whom tax has been charged on an *ad hoc* basis in respect of the income of a vessel to apply along with a return of his income that he may be assessed on the basis of the business income that actually arose to him in the previous year. On completion of the regular assessment the tax paid towards the *ad hoc* assessment shall be adjusted against the amount due from the assessee and the excess or deficiency, if any, shall be refunded to or recovered from the non-resident.

(G) Recovery of Tax in respect of the Income of a Non-resident (Section 173): In the case of the non-residents the tax on the income which is deemed under Section(9) (1) (i) to accrue or arise in India and is taxable as such may be recovered —(i) by deduction of tax at source : or (ii) by an assessment on the non-resident directly or (iii) by an assessment on the non-resident's agent in his representative capacity. Any arrears of such tax may also be recovered from any of the assets which may at any time come within India. But the arrears cannot be recovered by filing a suit in the foreign country where the non-resident principal resides since the Courts of one country have no authority to enforce the revenue laws of another.

Generally the proceedings for the recovery of tax cannot be commenced after the expiry of one year from the last day of the financial year in which the demand is made. But Section 231 specifically provides that this one year period of limitation does not apply to recovery of tax under this Section from the non-resident's assets in India. This Section applies only where the income is covered by Section (9) (1)(i); it cannot be made to apply for the recovery of taxes in respect of the income which is not deemed to accrue in India.

(H) Income earned in a financial Year assessed in the same financial Year—Exceptions to the general rule (Sections 174 to 176) : Generally the assessment year is always ahead of the previous year. In other words, income which is earned during one financial year is not charged to tax in that very same year but in the next following financial year. To this general rule, there are certain exceptions which are as under :

(1) *Persons leaving India* (Section 174) : Where it appears to the Income-tax Officer that any individual may leave India during the current financial year or shortly after its expiry and that there is no present intention of his returning to

India, the Income-tax Officer may proceed to assess his total income for the period comprised in the current financial year *i.e.* the total income of the period from the expiry of the last previous year, (if a previous year has already been determined in his case) upto the probable date of his departure.

The total income of each completed previous year or part thereof including in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessment must be made in respect of each such completed previous year or part thereof. The I.T.O. is entitled to estimate the income of the individual leaving India for such period or part thereof in cases where his income cannot be readily determined in the manner provided in the Act for the computation of income under each head.

For the purposes of making this assessment, the I.T.O. may serve a notice upon the assessee requiring him to furnish within such time (not being less than seven days) as may be specified in the notice a return, under Section 139 (2) setting forth his total income for each completed previous year comprised in the period of assessment, and his estimated total income for any part of the period. For all practical purposes this notice issued by the I.T.O. would be deemed to be a notice under Section 139(2). The tax chargeable on any individual under this Section shall be over and above the tax, if any, chargeable under any other provision of the Act. If an assessee does not furnish the return as required by the notice of the I.T.O., a best judgment assessment must be made on him under Section 144 ; non-compliance with the requirements of the notice may also attract liability to penalty under Section 271.

Assessment under this Section may be made even on the income of the period beyond the expiry of the assessment year if the probable date of the assessee's departure is after the expiry of the assessment year. In addition to the issue of notice for making an assessment under this Section, the I.T.O. may as well issue notice under Sections 139(2) and 148(1) requiring him to furnish a return and other relevant information within such period being not less than seven days, as he may think fit Thus, the Income-tax Officer is empowered to make more assessment than one on the person leaving India before his departure from India.

(2) *Persons trying to alienate their assets* (Section 175) : If it appears to the Income-tax Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of the whole or any part of his liability under the Income-tax Act, the total income of such person, for the period from the expiry of the previous year for that assessment year to the date when the Income-tax Officer commences proceedings under this Section shall be chargeable to tax in that assessment year itself. All the provisions of the Act shall apply to such proceedings as they apply in the case of a person leaving India.

(3) *Discontinuance of Business or Profession* (*Section 176*) : Where any business or profession is discontinued in any assessment year, an assessment may be made in that very year of the income from business for the period between the expiry of the previous year relevant to that assessment year and the date of discontinuance, in addition to the assessment, if any, made on the income, profits or gains of the earlier previous year or years. Thus, the Income-tax Officer has an option to make a premature assessment of the profits earned upto the date of discontinuance in the year of discontinuance instead of the usual financial year.

The term 'discontinuance' used in this context, refers to complete cessation of the business instead of a mere change of ownership or ´ ange in the constitution of firm. A change of ownership may involve succession a.., for purposes of this Section, a business must be regarded as being continued despite successive changes in its ownership. Since succession and discountinuance are two multually exclusive concepts there cannot be a discontinuance in cases where there is succession. If a part of the business of an assessee is dropped owing to its non-profitable nature, either permanently or temporarily, it would not imply that the business has been discontinued. In other words, inactivity in trade does not lead to the conclusion that the trade has been discontinued. There may be cases where the trade may be carried on even after the dissolution of the firm or the liquidation of the company. The amalgamation of two separate and independent business belonging to two distinct owners may result in the discontinuance of those business and the change of ownership. Where the business of a joint family or a firm is split up on partition of the family or the dissolution of the firm and the business is divided into branches or portions amongst the members, it would be a case of discontinuance of the old business even if some or all the members carry on their business in the same premises and take advantages of the old business connections. This is because of the fact that in such a case the assessee *i.e.*, the family or the firm, has ceased to carry on the business and there is no succession insofar as the integrity of the business is not preserved as was held in *Salt Nagjee Purushotam and Co. v. C I.T.* (1964) 51 *I.T.R.* 489 (*S.C.*).

In the case of a profession a firm may discontinue its profession though its partners may remain in the profession and *vice versa.* Where a professional man joins a firm, he does not cease to carry on his profession and only when he retires from the firm and ceases to practise once and for all he would be said to have discontinued his profession even though the firm in which he was a partner might continue to function after his retirement with or without new partners. In order to constitute proper discontinuance of the profession for purposes of this Section it is not essential that there should be a complete cessation of the professional practice for the rest of man's life. For instance, an advocate would be said to have discontinued his professional practice when he takes up a full-time assignment as a judge or a legal adviser; but after retirement or resignation from the service he is entitled to return to his professional practice again.

The total income of each completed previous year or part thereof included in the period for which assessment is to be made shall be computed separately and shall be chargeable to tax at the rate or rates in force in respect of each of the relevant assessment years. Any person discontinuing his business or profession must necessarily give notice to the Income-tax Officer of the fact of discontinuance within fifteen days from the date thereof. Failure to give this notice would entail the levy of penalty under Section 272. Discontinuance and dissolution of business or profession by an association of persons or a firm do not fall within the provisions of Section 176 as they are dealt with under Sections 177 and 189 respectively.

In the case of *profession*, which has been discountinued, any sum received in any year on account of the cessation of the profession by, or on the retirement or death of the person carrying on profession, after the date of discontinuance is deemed to be the income of the recipient and charged to tax accordingly in his hands as if the amount would have been included in his total income if it had

been received before the discontinuance. This specific provision for taxing the receipts after discontinuance of the profession thus constitutes an exception to the general rule that professional receipts would be taxable only if the profession is carried on in the year of account : Section 176(4) applies only to a profession and not to a business discontinued.

According to sub-section (3A) of Section 176, in cases where any business is discontinued in any year, any monies received after the discontinuance of the business must deemed to be the income of the recipient and must be charged to tax accordingly as his income from business in the year of its receipt if such monies would have been included in the total income of the assessee who carried on the business had such monies been actually received prior to the discontinuance of the business.

The other procedural provisions in regard to service of notice, made of assessment, collection of tax *etc.* are the same as those applicable to a person leaving India, as discussed earlier.

(I) Liabilities arising when an Association carrying on Business is dissolved or Business is discontinued (Section 177) : Where any business or profession carried on by an association of persons had been discontinued or where an association of persons is dissolved the I.T.O. is bound to make an assessment of the total income of the association of persons as if no such discontinuance has taken place. Consequently, all the provisions of the Act, including those relating to the levy of penalty or any other sum chargeable under the Act would, so far as may be, apply to such an assessment. If the I.T.O. or A.C.C., or the Commissioner (Appeals) in the course of any proceeding under the Act, in respect of any association of persons is satisfied that the association of persons is guilty of any of the acts attracting the provisions of Sections 270 to 275, he may impose or direct the imposition of a penalty in accordance with those Sections.

Every person who was at the time of discontinuance or dissolution a member of the association of persons, and the legal representative of any such member who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act, so far as may be, shall apply to any such assessment, imposition of penalty *etc.* Where the dissolution or discontinuance had taken place after the commencement of any proceeding under the Act, the proceedings may be continued against the member of the association immediately prior to the discontinuance or dissolution and the legal representative of any deceased member from the stage at which they stood at the time of discontinuance or dissolution. The liability of the legal representative of any deceased member shall, however, be limited to the extent to which the state is capable of meeting the liability. But the legal representative will become personally liable for any tax payable by him in his capacity as the legal representative if, while his tax liability remains undischarged, he creates a charge on or disposes of or parts with any of the assets of the estate of the deceased which are, or may, come into his possession ; this personal liability shall, however, be limited to the value of the assets so charged, disposed of or parted with.

A society registered under the Societies Registration Act, 1860 is a legal entity separate and distinct from its members. Its members are not personally liable for the tax assessed and levied on the society, which is assessable as an

association of persons so long as the society is not dissolve' or its business is not discontinued [*Swami Sacthitanand v. I.T.O. (1964) 53 I.T.R. .. 3*].

(J) Companies under Liquidation (Sections 178 and 179) :

1. *In the case of all companies* (Section 178) : Every person (i) who is the liquidator of any company which is being wound up, whether under the orders of a Court or otherwise, or (ii) who has been appointed as the receiver of any assets of a company is bound under a statutory obligation to give notice of his appointment as liquidator or receiver, as the case may be. This notice may be given within thirty days of his appointment to the I.T.O. having jurisdiction to assess the income of the company. The I.T.O., in his turn, is bound, after making such enquiries or calling for such information as he may deem fit, to notify to the liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion, would be sufficient to provide for any tax which is then or is likely thereafter to become payable by the company.

The liquidator is debarred from parting with the assets of the company and its properties in his hands until he is notified by the I,T.O. of the amount which will be sufficient to provide for any tax which is then, or is likely thereafter, to become payable by the company *except* with the prior approval of the Commissioner and for a specific purpose *viz.*, payment of the tax payable by the company, payment to secured creditors whose debts are entitled under law to priority of payments over the debts due to the Government on the date of liquidation and meeting such costs and expenses of the winding up of the company as are, in the opinion of the Commissioner, reasonable immediately on receipt of the notice and before parting with any of the assets of the company directly or indirectly.

If the liquidator fails to notify the I.T.O. of his appointment within the time specified or fails to set aside the amount intimated by the I.T.O. as being sufficient to provide for the tax liability of the company or parts with any of the assets or property for the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay or, as the case may be, the amount intimated to him by the I.T.O. Failure to comply with the above requirements would be an offence punishable under Section 276A.

Where there are more liquidators than one, their obligations and liabilities under this Section are joint and several. The provisions of this Section have the effect of over-riding anything to the contrary contained under the Companies Act or any other law for the the time being in force and apply to all companies, public or private.

Leave of the winding up court is not necessary for an I.T.O. to commence or continue the assessment proceedings against the company in liquidation. An assessment cannot, however, be made on a company after it has ceased to exist and its name has been struck off the Register of Companies by the Registrar.

2. *In the case of a Private Company* (Section 179) : Where any private company is wound up and any tax assessed on the company, whether before or in the course of its liquidation in respect of any income of any previous year cannot be recovered, then, every person who was a director of a private company at any time during the relevant previous year shall be jointly and severally liable for the

payment of the tax *unless* he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation of the affairs of the company. The personal liability imposed by this Section on the directors of a private company shall have the effect of over-riding any provision under the Companies Act, 1956 by which the liability of the directors is reduced or curtailed. This various personal liability can be imposed by the I.T.O. on a direction even without an adjudication by a Court.

The directors of a private company would be personally liable to pay the taxes due from the company not only at the time when the company is wound up but even in cases where the company is not in liquidation. Thus, the directors of a private company are jointly and severally liable for the payment of any tax due from a private company in respect of its income liable to tax in any accounting year from any other company in respect of any income of any previous year during which time such other company was a private company. In cases where a private company is converted into a public company and the taxes assessed in respect of any income of any previous year during which such company was a private company could not be recovered from the company, then, any tax due in respect of the income of the private company could be recovered from any of the person who were directors of the private company before a public company. However, the personal liability of the directors has been restricted to the taxes due in respect of the assessment years commencing on or after the 1st April 1962. The directors would be free from this personal liability to pay the taxes of the company, if it could be proved that the non-recovery of the taxes due from the private company is not attributable to any gross negligence, misfeasance or breach of duty on their part in relation to the affairs of the private company.

(K) **Liability of State Governments** (Section 181) : Income-tax shall be payable by a State Government on any securities issued by it as tax-free at such rate not exceeding 25% as may be notified by the Central Government from time to time in the Official Gazette.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL F.S.P. (N) I. Tax-6

FINAL COURSE (N)

INCOME-TAX

STUDY-VI

TAXATION OF COMPANIES

Contents :

1. Meaning of a company and classes of companies for purposes of income tax
2. Tax liability of a company.
3. Additional income-tax on the undistributed profits of closely-held companies.
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5. Restriction on certain deductions in the case of certain companies.
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1. MEANING OF 'COMPANY' FOR PURPOSES OF INCOME-TAX :

Under the Income tax Act, the term "company" has a much wider meaning than what has been given to it under the Companies Act. The company is considered as a 'person' for all purposes of assessment proceedings [Section 2 (31) (iii)].

Section 2 (17) of the Income-tax Act, 1961 defines a company for income-tax purposes. Accordingly, 'Company' means (1) any Indian company (as defined in Section 2 (26) and explained later or (2) any body corporate, incorporated by or under the laws outside India or (3) any institution, association or body assessable as a company either under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1st day of April, 1970, or (4) any institution, association or body, whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the Central Board of Direct Taxes to be a company.

Tax Liability ; A company is a juristic person and becomes a body corporate upon the issue of the certificate of incorporation ; it is a legal person separate and distinct from the shareholders. The legal personality of a company created by the statute can also be modified by legal fiction. For purposes of income-tax even an unincorporated association may be declared by the Board to be a company and, consequently, what is not a legal entity in the eyes of law may be assessable as a company. Even companies which have no share capital and those which are limited by guarantee are companies for purposes of the Income-tax Act even though the general framework of the Act mainly contemplates companies with share capital. A chamber of commerce or any association without a profit motive and registered under Section 25 of the Companies Act, 1956 would be a company for income-tax purposes. The tax liability of such non-profit making associations arises in respect of the profits from specific services to their members under Section 28 (iii). A company incorporated for a purpose other than that of carrying on a business, a company in liquidation, a statutory corporation, the Government of any State carrying on a trade or business would be deemed to be a company within the meaning of the Income-tax Act for the purposes of levy and collection of tax on the business profits assessable to income-tax. However, an assessment cannot be made on a company after it has ceased to exist and has been struck off the register of companies. Holding companies and their subsidiaries have to be separately assessed in respect of their profits since they are separate and distinct legal entities.

Since the law does not prescribe any minimum number of shares to be held by a shareholder nor a maximum, even a one-man company is distinctly assessable legal entity as much as any other company. However the income-tax authorities are entitled to examine the genuineness and the true nature of the connected transactions of such a company. A company being a separate legal entity, the mere fact that only one individual is beneficially interested in all the shares and

that the company, in effect, acts as his agent or nominee will not, by itself make its income the income of the shareholder. However, the Income-tax Officer can tax the shareholders after examining the genuineness of such one man companies on the basis of the true nature of the transactions *e.g.*, when dividends are disguised as loans, when the company is doing the business of the individual who controls it.

As the Supreme Court has observed in *CIT*, vs. *Shri Meenakshi-Mill Ltd.* *(1967) 63 ITR 609*. "It is true that from the juristic point of view the company is a legal personality entirely distinct from its members, and the company is capable of enjoying rights and being subjected to duties which are not the same as those enjoyed or borne by its members. But in certain exceptional cases, the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent a tax obligation.

A foreign company or association which desires that the status of a 'company' be accorded to it, for pupopses of assessment under the Income-tax Act, must apply to the Central Board of Direct Taxes for such a status to be vested in it. Generally, the Board agrees to grant such a status to every foreign body corporate or association possessing the usual characteristics of a company limited by shares and having a separate legal personality recognised by the laws of the country in which the body corporate or association has its registered office. However, since the purpose in obtaining the status of a company obviously is to obtain a reduction in the rate of tax at which the body corporate or association would be otherwise taxed, before any foreign body corporate or association is invested with the status of a company, the Central Board of Direct Taxes examines the loss of revenue that such a concession would involve.

Since the company itself is chargeable to tax on its income as a distinct taxable entity, it pays the tax in the discharge of its own liability and not on behalf of or as the agents of the shareholders as was held by the Supreme Court in *Howrah Trading Co. Ltd.* v. *CIT.* (1959) *36 ITR 216* and *Purshotamdas Thakurdas* v. *CIT* *(1963) 48 ITR 206*. Consequently, the shareholders whether corporate or non corporate, are liable to tax in respect of the gross dividend without any credit for the tax assessed in the hands of the company unless a specific provision is made in the Act to the contrary. The tax payable by the company should not be confused with the tax payable by the shareholders which it deducts at source from the dividends or other items of income under Sections 19. to 195 of the Act. In such cases, the tax is deemed to have been deducted and paid by the company on behalf of the the recipient shareholders of the income and credit for the same shall be given to them in their individual assessments.

CLASSES OF COMPANIES

(*i*) *Indian Company* [Section 2 (26)]; An Indian company means a company formed and registered under the Companies Act, 1956 and includes—

(a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the Union territories specified in clause c, below);

(b) In the case of the State of Jammu and Kashmir a company formed and registered under any law for the time being in force in that State;

(c) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory and

(d) any corporation established by or under a Central, State or Provincial Act and having its registered or principal office in India, and also any institution, association or body which is declared by the Board to be a company under Section 2 (17) where the principal office of the institution, association or body is in India.

It is however, essential that in all cases the registered, or as the case may be, the principal office of the company, corporation, institution, association or body must be in India.

(*ii*) *Domestic and Foreign*: The Income tax Act as well as rate structure classifies companies into two groups, viz (1) Domestic companies (2) Foreign companies. The term 'Domestic Company' means an Indian company or any other company which, in respect of its income liable to tax under the Income tax Act, has made the prescribed arrangements for the declaration and payment within India of the dividends including dividends on preferential shares payable out of such income [Section 80B (2)] of the Income tax Act and Rule 27 of the Income.-ax Rules]. A company that is not a domestic company is a foreign company [Section 80 B (4) J].

(*iii*) *Closely-held and widely-held*: Domestic companies are again divided into two broad groups, viz, (1) companies in which public are substantially interested and (2) companies in which public are not substantially interested. The former type of companies are also referred to as "widely-held companies" while the latter are also referred to as 'closely-held companies'.

To determine whether a company is one in which the public are substantially interested, one has to apply the tests laid down in Section 2 (18). Briefly the following companies fall under this category (1) companies owned by the Government or the Reserve Bank of India or in which not less than 40% of the shares are held by the Government of the Reserve Bank or India or a corporation owned by

that bank (2) companies registered under Section 25 of the Companies Act. [i.e. a company having as its object the promotion of commerce, arts, science, religion, charity or any other useful object and which prohibits payment of dividends to its members], (3) companies having no share capital but declared by the Board to be companies in which the public are substantially interesed, (4) public limited companies whose shares are quoted in the stock exchange and (5) public limited companies whose equity shares carrying not less than 50% (40% in the case of industrial companies) of the voting power have been allotted unconditionally to or acquired unconditionally by and were throughout the relevant previous year beneficially held by the Government or statutory corporation or other widely-held companies or their subsidiaries, whose entire share capital has been held by the parent company throughout the previous year.

Thus, it may be noted that all public limited companies need not necessarily be treated as companies in which public are substantially interested, whereas all private limited companies will be treated as companies in which public are not substantially interested. The broad classification has got a direct bearing on the tax liability of the company in view of the fact that a company in which the public are substantially interested is taxed at lower rates of taxation, as compared to the other type of companies as will be evident from the tax rate structure given later. Further tax payable by a widely-held company (including Companies Profits Surtax) is, subject to a ceiling limit of 70% of total income in certain cases. This ceiling is, however, not applicable to closely-held domestic companies and foreign companies.

It may be noted that the definition of a company in which the public are substantially interested is relevant for purposes of Section 104, for determining the rate at which income-tax is payable by such a company on its taxable income and for the application of Sections 2 (22) (e) and 79.

(*iv*) *Industrial & Non Industrial*: In the case of a company in which public are not substantially interested the tax rate structure makes a further classification as industrial companies snd non industrial companies. Industrial companies receive preferential tax treatment and some of the disabilities attached to a company in which the public are not substantially interesed are not applicable to an industrial company even though such a company may be one in which public are not substantially interested. The term "industrial company" means a company which is *mainly* engaged in the business of generation or distribution of electricity or any other form of power or carriage by road or inland waterways of passenger or goods or in the construction of ships or in the execution of projects or in the manufacture or processing of goods or in mining. If the income attributable to any one or more of these activities included in the total income of the company for the relevant previous year is not less than 51% of such total income, such a company will be deemed to be an industrial company. Thus, for instance, all manufacturing companies are industrial companies.

Illustrations : 1. *C.I.T.* v. *Fiberglass Pilkington Ltd. (1981) 7 Taxman 225 (Bom)*. The assessee company's 45 per cent shares were held by members of public and, though its primary objective was to engage in manufacturing of goods, its only source of income was from investments in the interregnum between its formation and commencement of manufacturing activity. It was held that the absence of manufacturing activity by the assessee company during the relevant previous year would not take it out of the ambit of Explanation 2 to Section 2 (18) nor would the fact that its memorandum of association empowered it to carry on other non-manufacturing activities would make it one which was not wholly engaged in the manufacturing of goods.

Section 2 (18) has no reference to the character or nature of the income of the company. It has reference to the character or nature of the activity of the company. Receipt of income from a source other than the manufacture will not therefore deprive the company of is true character as a manufacturing concern.

2. *Orient Longman Ltd.* v. *C.I.T. (1981) 130 I.T.R. 477 (Delhi)*: Books in the manufactured stage are goods and their manufacturing or processing is, as in the case of other goods, the conversion of paper and the manuscript written by an author into a book. This certainly involves manufacture or processing. The fact that printing and binding is done by someone else does not imply that someone else is the manufacturer. In view of the aforesaid principles the assessee company in the instant case which was carrying on business in the publication, sale and purchase of books, was an industrial company.

Special Provisions : Apart from the differential rate structure, applicable to the two broad categories of companies in which the public are substantially interested and those in which the public are not substantally interested there are certain special provisions which are applicable only to the latter type of companies. These relate to the provisions governing deemed dividends under Section 2 (22)(e), compulsory distribution of dividend and the levy of additional income-tax on undistributed profits under Sections 104 to 109 in the event of failure to distribute the 'statutory percentage' of the distributable income, carry forward of losses under Section 79 and liability of Directors under Section 179. Under certain circumstances tax implications may also arise under other related tax laws like the Gift-tax Act, Wealth-tax Act or the Estate Duty Act.

(v) *Banking and financial companies* : The Income tax Law recognises banking companies [Explanation (a) to Section 40 A (8)] and financial companies [Explanation (c) to Section 40A (8)]. Non-banking and non-financial companies are subject to the disallowances as per Section 40 A (8) under which a specified portion of the interest paid on deposits is disallowed in the computation of their total income.

(vi) *Other Companies* : The provisions of Sections 104 to 109 governing the levy of additional income tax on undistributed profits also recognise the following types of companies :—

(a) Consultancy service company Section 109 (ib)

(b) Investment company Section 109 (ii)

(c) Trading company Section 109 (iia)

The nature of the business activities of the proposed company would essentially determine whether it would be an industrial or a trading company or other company or a combination of two or more types of the companies. Even while deciding about the nature of activities, the tax implications need to be considered with reference to the tax benefits and reliefs as well as disincentives applicable to the proposed activities. For instance, a trading company may extend its business to export trade in order to avail the concessions available under Section 80 HHC and such other incentives as may be provided under the related laws like Foreign Exchange Regulations Act, Customs and Excise Laws. Manufacturing or other industrial companies are in a position to avail of a number of tax incentives like depreciation, investment allowance, tax holiday, lower rates of income-tax etc. Special tax incentives have also been provided to certain priority industries, agro-based industries, new undertakings and industries providing technical know-how service and sales. These tax implications should be duly considered alongwith other relevant factors such as business conditions, market potential, profitability, economies of scale, relevant government controls, regulations etc.

Tax Liability of a Company

A company is chargeable to income-tax on its total income that had accrued or arisen in the previous year calculated under the different heads of income and in accordance with the basic principles explained in Studies I, II and III. The determination of the total income of a company is dependent on whether or not the company was resident in India during the relevant previous year. Study I discusses in detail as to how the residential status of a company is to be determined and it also explains how to determine the scope of total income of a company under Section 5. Students are also advised to study the provisions of Section 9 explained in Study I which has much relevance to company taxation.

Thus we may conclude that the liability of a company to tax depends on the following ;

(a) Whether it is an Indian company as defined in Section 2 (26).

(b) Whether the company has made the prescribed arrangements for the declaration and payment of dividends within India or not (Rule 27).

(c) The pattern of its shareholding: Is it a company in which the public are substantially interested or a subsdiary of such a company ?

(d) Is it a company attracting the provisions of Section 104 ?

(e) Whether it is an industrial company deriving at least 51% of its total income from industrial activity.

Rates of Tax

Assessment Year 1984-85

DOMESTIC COMPANIES

Nature of income	Widely held	Closely hold Industrial	Closely hold others	Surcharge
Income other than Long Term Capital Gains	55%	60%	65%	5% of Income Tax
Long Term Capital Gains				
Relating to buildings or lands or any rights therein. (Section 115)				
If total income other than LTCG is less than Rs. 1,00,000	40%	50%	50%	Nil
In any other case	50%	50%	50%	Nil
LTCG relating to any other assets	40%	40%	40%	Nil

NON-DOMESTIC COMPANIES

Royalties from Govt. or Indian company as per approved agreement made between 1.4.61 and 31.3.75	50%	5%
Technical fees from Govt. or Indian company as per approved agreement made between 1-3-69—31-3-76	50%	5%
Balance of Total Income	70%	5%

Important Note : The Finance Act 1983 has enlarged the scope of the definition of the expression "industrial company" so as to cover a company which derived not less than 51% of its total income from the business of generation or distribution of electricity or any other form of power or *in the carriage, by road or inland waterways, of passengers or goods or in the construction of ships or in the execution of projects or in the manufacture or processing of goods or in mining* This new definition is applicable with effect from assessment year 1984-85.

Students should carefully note that the extended definition of an industrial company is only for the purpose of concessional treatment in the matter of rate of

tax. It has no application for Section 104 (4) (a). See discussion under additional income tax on undistributed profits-similarly, there is no unform defintion of industrial company' for the purposes of Sections 10A, 32A, 80HH, 80HHA, 80 I and 104.

Companies are taxed at flat rates, as stated above, as distinguished from the progressive rates of taxes applicable to individuals, Hindu undivided families and unregistered firms. The initial exemption of an income of Rs. 15,000 from tax available to these entities does not also apply to companies.

Students may note that the percentage of surcharge payable has been increased from 2-1/2% to 5% by the Finance Act 1983 with effect from the assessment year 1984-85. However, a company may, in lieu of payment of the amount of surcharge on income-tax, make a deposit with IDBI under any such scheme as the Central Government may by notification in the Official Gazette, frame in this behalf. Where the amount of the deposit so made is equal to or exceeds one-half of the amount of surcharge on income-tax payable by the company, the surcharge payable by it shall be reduced to nil. Where the amount of deposit so made falls short of the amount of surcharge, the surcharge payable by the company shall be reduced by the amount of the deposit so made. The Central Government has recently notified the scheme which is known as 'The Companies Deposits, (Surcharge on Income-tax) Scheme, 1983 [vide notification No. GSR 704 (E) dated September 14, 1980].

Tax on Income from Life Insurance Business : Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions the income-tax payable in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act the income-tax payable shall be the aggregate of (i) the amount of income-tax calculated on the income from life insurance business included in total income at the rate of 2-1/2 per cent and (ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business. No surcharge is also payable on the income-tax calculated under Section 115B.

Taxation of Non-resident Companies : Though the rates at which tax would be payable by such a company on the different categories of its income are stated above, it is necessary to clarify that income-tax at the rate of 70% on income other than income from royalties and fees for technical services received under an agreement approved before 1.4.1976 by the Government of India would be levied only after taking into consideration the various exemptions and reliefs to which such a company is entitled under the Act. A non-resident company which operates through an Indian branch would also be liable to pay tax at the rate of 70% on its income derived from a branch in India. The non-resident shareholders of such a company, when it declares dividends outside India would not have to pay any tax in India on their individual income even though the dividends would have been declared out of profits made by the company in India.

Foreign companies deriving income from royalties, patents, licence fees and fees for technical services in India are liable to be taxed in India. In the case of fees for technical services rendered, only that portion of the income which relates to the services rendered in India is liable to tax in India and that received for services rendered outside India is not so liable. In respect of the income arising to a foreign company in India by way of royalties or fees for technical services rendered, a concessional rate of tax is applicable. The concessional rate of tax in the case of royalties or fees for technical services is 50% but it can be availed of only if the royalties or fees are received in pursuant to an agreement approved by the Government of India. For claiming the concessional rate of tax the agreement in question which gives rise to the income should have been approved by the Government after 31st March, 1961 in the case of royalties and 29th February, 1964 in the case of fees for rendering technical services but before 1.4.1976.

Special Rates of Tax for Taxing Dividends, Fees for Technical Services and Royalties in the case of Foreign Companies (Section 115A): Where the total income of a foreign company includes any income by way of

(i) dividends

(ii) interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency or

(iii) royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with the Government or the Indian concern after 31.3.76 and where such agreement is with an Indian concern, such agreement is approved by the Central Government ;

The income tax payable on the abovementioned types of income will be as follows :

(a) Tax @ 25% on dividend income

(b) Tax @ 25% on interest income

(c) (i) Tax @ 20% on so much of the amount of royalty income as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, model design secret formula or process or trade mark or similar property.

(ii) Tax @ 40% on the balance of income by way of royalty and

(d) Tax @ 40% on income by way of fees for technical services.

Income by way of royalties received by a foreign company from any Indian concern will be chargeable to tax at the rate of 40% in cases where the royalty is received in consideration for the transfer of copyright in any book or books on a subject which are, according to the Import Trade Control Policy of the Government

of India permitted to be imported under an Open General Licence, irrespective of the fact whether the agreement under which the royalty is paid is approved by the Central Government or not.

Interest on loan earned by a foreign company Exemption is available under section 10 (15) (iv) in respect of interest payable by an industrial undertaking on the money borrowed by it and from a financial insitution or anyone else in respect of the purchases of raw material or components or plant and machinery in a forign country provided that the loan arragement has been approved by the Central Government having due regard to the terms of the loan or debt and its repayments. The details of these exemptions have been discussed in Study Paper I.

Except in cases where the benefit of an exemption can be availed of, a non resident company will have to pay tax on the interest received by it on loans advanced in India at the the rate of 70%. From the foregoing discussion it would be clear that the incidence of tax on a non-resident company differs according to and depends upon the type of income earned in India and the form of organisation through which the company operates in India. If the foreign company operates through an Indian company, in which the public are substantially interested, the incidence of tax is lower than when it operates through a closely held Indian company in which the public are not substantially interested.

Other special provisions: Section 44D incorporates special provisions for computing income by way of royalties and fees for technical services chargeable to tax in the case of foreign companies and these provisions would apply notwithstanding anything to the contrary contained in Section 28 to 40C. These provisions have been explained in Study III under the head "Profits and Gains of Business or Profession". The special provisions in respect of deduction of head office expenditure, applicable to all non-residents, contained in Section 44 C have also been explained in Study III. Moreover. Sections 57 and 80M disallow the deductions otherwise admissible under these Sections with reference to taxing the dividends received by foreign companies. Section 58 also provides that the provisions for disallowance contained in Section 44D, would, so far may be, apply to foreign companies computing their income under head 'Income from Other Sources' as they apply to computation of business income. All these special provisions should be borne in mind while determining the liability of foreign companies to income-tax in India.

3. ADDITIONAL INCOME TAX ON UNDISTRIBUTED PROFITS OF COMPANIES (Section 104 to 109)

Companies which are closely held can avoid payment of heavy tax by its small number of shareholders in their individual assessments by not distributing sufficient dividedns. The income-tax Act in order to counteract such a practice has inserted chapter XI in the Income-tax Act containing sections 104 to 109. Accordin-

gly such companies have to pay an additional income tax if the amount of dividends declared by them in respect of a particular year falls short of the prescribed minimum. Such fixed percentage would be distributed within a period of twelve months from the end of the relevant previous year.

Statutory Percentage : The percentage of profits that are distributable by the various classes of companies are stated in clause (iii) Section 109).

Statutory percentage' of 'Distributable Income' that is required be distributed as dividend

Closely held companies

- Companies having accumulation. If the accumulation of the profits which was not subject to an order u/s 104, exceeds the paid up capital and the loan capital or the book value of fixed assets which ever is greater – 90%

  In the case of non-trading companies the statutory percentage of 90% would be attracted only if the accumulated profit exceeds *twice* the amount of paid up capital and loan capital or the book value of fixed assets, which ever is greater.

  In the case of Indian Company, not being an industrial company or a consultancy service company a part of whose gross total income consists of profits from industrial activities or consultancy service activities and a part from other activities, the applicable rates of statutory percentage are as follows :

- Others
  - Consultancy service companies 45%
  - Investment Companies 90%
  - Any other Companies (like trading) 60%

(a) in respect of profits attributable to industrial activities—nil

(b) in respect of profits attributable to consultancy service activities—45%.

(c) in respect of profits attributable to other activities

(i) If it is an Investment company or a company having accumulations exceeding the paid up capital and the loan capital or the book value of assets (in the case of non-trading company, twice such amount) whichever is greater. — 90%

(ii) in the case of other companies. — 60%

From the definition of statutory percentage discussed above, it may be seen that different statutory percentages may have to be applied to different types of profits, of the same business and for this purpose the profits of a single business may have to be notionally apportioned to the various activities in a suitable manner.

Trading company [Section 109 (ii) (a)] : For purpose of additional income-tax the expression 'trading company' means a company whose business consists wholly or mainly in goods or merchandise manufatured, produced or processed by a person other than that company and whose income attributable to such business included in its gross total income is not less than 51% of the amount of such gross total income.

Investment Company [Section 209 (ii] : The expression 'investment company' means any company whose gross total income consists mainly of income chargeable under the heads. "Interest on securities," "Income from house property", 'Capital gains" and "Income from other sources".

Consultancy Service Company: For purposes of additional income-tax, the expression '*Consultancy Service Company*' has been defined in sub clause (ib) of Section 109 to mean an Indian company, whose business consits of *wholly* the provision of technical know how or the rendering of technical services in connection with the provision of technical know-how to other persons. For this purpose the expression "*provision of technical know-how*" would consist of *one or more* of the following activities :—

(i) the transfer of all or any rights including the granting of a licence in respect of a patent, invention, model, design, secret formula or process or similar property

(ii) the imparting of any information concerning the working of the use of a patent, invention, model, design, secret *formula or process or* other similar property :

(iii) the use of any patent, invention, model, design; secret formula or process of similar property ;

(iv) the imparting of any information concerning industrial, commercial, scientific knowledge, experience or skill.

Students may note that Section 80MM has been omitted with effect from 1.4 84 by Finance Act, 1983. Hence the meaning assigned for the expression "provision of technical know-how" under sub-section (2) of section 80 MM has been incorporated in section 109 itself as an explanation to section 109 (i) (b) with effect from 1.4. 1984.

Illustration 1

A Co. (P) Ltd. (which is neither a trading company nor an investment company nor a manufacturing company) has balance sheet as at 31.12.83 as below ;

Liabilities	Rs.	Assets	Rs.
Paid-up capital (including bonus shares of Rs. 2,00.000)	10,00,000	Building	4,00,000
		Plant & Machinery	9,00,000
Reserves	6,00,000	Debtors	7,50,000
		Cash	2,00,000
P &L account	2,00,000		
Liabilities	4,50,000		
	22,50,000		22,50,000

What is the statutory percentage of its distributable income ?

Answer :

Accumulated profit and reserves including capitalised profits	(a)	10,00,000
Twice the value of paid-up capital excluding bonus shares	(b)	16,00,000
Twice the value of fixed asset	(c)	26,00,000

Since (a) is not in excees of *each* of (b) and (c) the statutory percentage is 60%.

Exemptions (Sections 104 and 108) : In order to break the rigours of the provisions under Section 104 requiring the compulsory distribution of minimum percentage of profits by different classes of companies the following *exemptions* have been granted ;

(1) No additional income tax can be imposed on a company if it has distributed by way of dividends the statutory percentage of its distributable income computed in accordance with Section 109 (i) within a period of twelve months immediately following the expiry of the relevant accounting year [Section 1 4 (1)]. If the failure of the company to declare the required amount of dividends is due to the operation of some other law for time being in force or an order of a competent Court prohibiting the company from paying any dividend or a larger dividend than that declared, no additional income-tax can be levied on such a company.

(2) The Central Government may, if it is of the opinion, that it is necessary or expedient in the public interest, to exempt any class of companies to which the provisions of Section 104 are applicable, grant them the exemption from the operation of the provision relating to the levy of additional income tax [Section 104 (3)]. In exercise of the powers conferred on it by Section 104 (3)]. The Central Government has exempted every Indian company (other than an investment company) from the operation of this Section in respect of the previous year relevant to the assessment year commencing from 1.4.1976 provided that *both* the following conditions are fulfilled ;

(i) the company is engaged in (a) any business of exporting goods or merchandise out of India or (b) any business which involves the performance of any constructional or manufacturing operations or rendering any service outside India ; and

(ii) in respect of the relevant previous year the amount of sale proceeds derived by the company from the export of goods or merchandise or gross receipts derived by it from its operations or

services outside India as the case may be, is not less than 51% of its total sale proceeds or receipts credited to its profit and loss account.

3. The provisions of Section 104 do not also apply in cases where the company is an *industrial company* ∴ an Indian company whose business consists mainly in the construction of ship or in the manufacture or processing of goods or in mining or in the generation of distribution of electricity or any other form of power, if the income attributable to any of the aforesaid activities is not less than 51% of the total income of the company [Section 104 (4) (a)].

It is significance to note that the new expanded definition of industrial company—as given in part III of the First Schedule to the Finance Act, 1983 has no application for Section 104 (4) (a). Consequently a closely held company engaged in the carriage by road or inland waterways of passengers or goods or in the execution of projects will be liable to levy of additional income tax if they fail to distribute the statutory percentage of distributable income. Such type of *companies will be treated as industrial companies only for the purposes of concessional* rates of tax.

4. No liability to additional income tax would arise in cases where the company is neither an Indian company nor a company which has made prescribed arrangements for the declaration and payment of dividends within India *i.e.* a foreign company. [Section 104 (a) (b)].

5. Further (i) any public company, in which the public are substantially interested or (ii) a subsidiary of such a company if the whole of the share capital of such subsidiary company has been held by the parent company or its nominees throughout the previous year would also be exempt from liability to additional income tax (Section 108).

Illustration 2

The total income for assessment year 1983-84 of a company in which the public are not substaintially interested is as under :

	Rs.
Interest on securities	10,000
Income from house property	40,000
Income from business	
(a) Share dealings	80,000
(b) Transportation of goods by road	1,40,000
Income from other sources	4,000
	2,74,000

Do you think that the company can claim exemption as an industrial company ?

Answer :

No. It is true that income from transportation of goods by road constitutes more than 51% of the company's total income. However, the scope of exemption granted to certain types of companies by Section 104 (4) (a) does not extend to all types of companies coming within the scope of the term 'industrial company' as defined in Part III of the first schedule to the Finance Act 1983. The latter definition is only for the limited purpose of applying the concessional rate of tax.

Reduction of Minimum Distribution (Section 107 A) : If the Central Board of Direct Taxes on the basis of the application made by a company (other than an investment company to which Section 104 is applicable), is satisfied that having regard to the current requirements for the development of its business a distribution equal to the statutory percentage of the distributable income of the company would not be possible or advisable, it may grant a reduction in the amount of minimum distribution required by the company by an amount not exceeding 20% of the statutory percentage. The application to the Board should be made by the company in Form No. 44A in accordance with Rule 111A within a period of 12 months immediately following the expiry of the relevant previous year or within 30 days of the receipt of the notice served on it by the I.T.O under sub-section (1) of Section 105. The application must be accompanied by a fee of Rs. 100. Where an application is made by the company to the Board the Income-tax Officer shall not pass any order under section 104 until the Board gives its decision. Moreover, where an application is made by a company after receipt of the notice from the I.T.O. under Section 105 (1) and a further distribution is made in accordance with the decision of the Board, such further distribution shall not be taken into account in deciding whether or not the provision of Section 104 would apply in respect of the previous year in which the further distribution is made. The Board is authorised to delegate the power exercisable by it to any Commissioner of income tax in respect of such companies as it may desire. The Board cannot reject the application made under this Section without giving the assessee a reasonable opportunity of being heard. The Board's decision however, is final and cannot be made the basis of any appeal.

Further, if the Central Government is of the opinion that it is necessary or expedient in the public interest so to do, may, by notification in the official Gazette declare that the provisions of this Section shall not apply to any class of companies or in regard to the whole or any part of the profits and gains of any class of companies.

Computation of distributable income [Section 109 (1)] : The distributable income of a company shall be its *gross total income* assessed for income tax purposes in respect of the relevant previous year as *reduced by* –

(i) the amount of income-tax (excluding the additional income-tax payable under the Section 104) payable by the company in respect of its total income ;

(ii) the amount of any other tax levied under any law for the time being in force by the Government or a local authority which has not been allowed to be deducted, computing the total income of the company for the relevant previous year (*e.g.* surtax on the company's profits) ;

(iii) the amount of any donations made by the company for charitable purpose qualifying for a deduction under Section 80G ;

(iv) losses under the head 'capital gains' relating to capital assets other than short-term capital assets ;

(v) income arising outside India in a country whose laws prohibit repatriation Where such prohibition is removed, any reduction allowed will be deemed to be a part of the distributable income of the previous year in which the prohibition is removed.

(vi) the amount actually transferred to a reserve fund under Section 17 of the Banking Regulation Act, 1949 – (in the case of a banking company only).

(vii) any expenditure actually incurred for the purposes of the business, but disallowed in computing the income chargeable under the head "Profits and gains of business or profession" being (a) bonus or gratuity paid to an employee, (b) legal charges, (c) any expenditure as is referred to in Section 40 (c) of the Act and (d) other expenditure claimed to be of a revenue nature not resulting in the creation of an asset or in the enhancement of the value of an existing asset ; and

(viii) any (revenue) expenditure wholly and exclusively incurred for the purpose of making or earning any income included in the gross total income other than income chargeable under the head "profits and gains of business or profession" but disallowed in computing such income not resulting in the creation of any asset or enhancement of the value of an existing asset. The distributable income of a company does not necessarily mean the income of the company as shown in its accounts ; it refers to the gross total income a part of which may not be taxable in the hands of company. Gross total income for this purpose means the total income computed in accordance with the provisions of the Act before making any deduction under Chapter VI A.

Rates of Additional Income tax [Section 104 (1)] : A company which fails to distribute the statutory percentage or its distributable income as determined under Section 109 (i) by way of dividends as defined in Section 2(22) within the

12 months immediately following the expiry of the relevant previous year is liable to pay additional income tax at the rate of—

(a) 50% in the case of an investment company ;
(b) 37% in the case of a trading company ; and
(c) 25% in the case of any other company.

In order to arrive at the amount on which such tax is payable, the distributable income must be reduced by the amount of dividends, if any, actually distributed during the 12 months from the end of the relevant previous year. Thus in a case where the company's distributable income is Rs. 10,00,000 and the statutory percentage applicable to it is 60% if the company had distributed dividends of Rs 5,00,000 the additional income-tax payable by the company will be computed on a sum of Rs. 5,00,000 (*i.e.*, Rs. 10,00,000 less Rs. 5,00,'00) and not on Rs 1,00,000 only. If, however, the company had distributed dividends of Rs. 6,00,000 already, it would not be chargeable to additional income tax.

Thus the additional tax is to be levied on the undistributed parts of the distributable income and not merely on so much of the income as is required to make up the distribution equal to the statutory percentage applicable to the company. If a company distributes either no dividends or less than the statutory percentage, the entire undistributed balance will attract additional income-tax. If the profits are recomputed under Section 155 (7), the undistributed balance of the company's income after recomputation may also attract additional income-tax at the appropriate rates.

Circumstances in which additional income-tax is not payable : The Income tax Officer would be precluded from making an order for payment of additional income-tax in case where he is satisfied that:

(1) having due regard to the losses incurred by the company in earlier years or to the smallness of the profits made in the relevant previous year the payment of a dividend or a larger dividend than that declared within the period of twelve month would be unreasonable ;

(2) the payment of a dividend if no dividend has been declared or a larger dividend than that declared within the period of twelve months would not have resulted in a substantial benefit to the Revenue ; or

(3) at least of 75% of the entire share capital (including preference shares) of the company throughout the previous year was beneficially held by an institution or fund established in India for a charitable purpose income from dividends whereof is exempt from tax under Section 11. [Section 1 4 ( )].

In the first case two things are to be considered. (1) Losses incurred by the company in the *earlier* years. ( ) smallness of the profit made in the *previ us* year. Thus it is clear that in respect of losses the period preceding the previous

year is mentioned. No such reference is given with regard to the profit made. Therefore, the test whether it would be rea- nable to distribute a large dividends has to be adjudged in the light of the *profit of the year in question.*

Profits : Does the term "Profits" refer to commercial profits, assessable profits or assessed profits ? The Supreme Court in *CIT* v. *Gangadhar Banerjee & Co. (P) Ltd. (1965) 57 ITR 176, 183* observed as follows :

"These two concepts, 'accounting profits' and 'assessable profits' are distinct. In arriving at the assessable profits the Income Tax Officer may disallow many expenses actually incurred by the assessee, and in computing his income, he may include many items on notional basis. But the commercial or accounting profits are the actual profits earned by an assessee calculated on commercial principles. Therefore, the words 'smallness of profit' in the section refer to actual accounting profit in comparison with the assessable profits of the year".

While computing profits for purposes of Section 104, regard must be had to commercial principles or a businessman's point of view. Simply because a particular expenditure is authorised by the memorandum of association of a company it cannot be assumed that every amount so spent can be justified on commercial principles or business considerations in determining the commercial or accounting profits. In the absence of a nexus direct or indirect between the expenditure and the business of a company, such a claim for deduction cannot justifiably be made.

In determining the commercial profits, the depreciation on the book value of the depreciable assets may be deducted even though the depreciation allowable as per Section 32 is a lesser figure.

In considering the reasonableness of the dividend distributed by the company the Income-tax Officer must take into account important factors such as depreciation to the value of the investments which are shown at cost in the accounts, depreciation on the fixed assets according to commercial practice, whether the depreciation is charged in the accounts or not capital expenditure and losses incurred, past losses, present profits, availability of surplus funds for dividends requirements for future expansion, the borrowings, the need to create payment of a reserve for bad and doubtful debts and the general financial position of the company. But the smallness of the profits and past losses are not the only factors to be taken into account by the Income tax Officer. Other factors to be taken into account before assessing the reasonableness of dividend distributed by the company are :

1. A bona fide provision for bonus.
2. Legitimate requirements for incurring expenditure of capital nature.
3. Capital loss incurred by the assessee.
4. Development projects, actual payment of taxes and other business and commercial consideration.

5. Liabilities for penalty imposed upon the company under the I.T. Act.

6. Current and anticipated taxes and those in arrears.

7. Accumulated profits cannot be taken into account in determining the applicability of Section 104 except for judging the overall financial position of the company.

Special Provisions for Certain Companies (Section 105) : An order under Section 104 shall not be passed by the Income-tax Officer without a notice for further distribution in the case of the following companies :

(a) Where the company is an investment company which has distributed not less than 80% of its distributable income within the period of 12 months aforesaid ; or

(b) Where the distribution made by a company (other than an investment company within the period of 12 months falls short of the statutory percentage by not more than 10% of its distributable income ; or

(c) Where the company has distributed within the period of 12 months the statutory percentage of its distributable income in accordance with the income returned but the income assessed subsequently is higher due to the assessment having been made under Section 143 or 144 and the difference is not on account of the application of the Proviso to Section 145 (1) or 145 (2) or Section 144 of the company to disclose its income fully and truly ; or

(d) Where company is one on which a reassessment has been made under Section 147 (b) and the company has distributed an amount below the statutory percentage.

The special concessions are subject to the condition that the company makes good the deficiency within three months of the receipt of a notice in this behalf from the Income-tax Officer. Any further distribution made by the company in pursuance of a notice issued by the I.T.O. under Section 105 (1) cannot again be taken into account in deciding whether or not an order for payment of additional income tax should be made on the company in respect of any subsequent year. It is only if the company fails to make a further distribution within three months of the receipt of the notice in such a way as to bring up the total distribution to at least the statutory percentage, the I.T.O. is empowered to pass an order under Section 104 in all the above four cases.

Period of limitation for making an order (Section 106) : According to the provisions of Section 106, no order of the Income-tax Officer imposing liability for additional income tax on any company shall be passed at any time after the expiry of :—

(1) four years from the end of the assessment year relevant to the previous year in respect of which the liability to additional income tax is sought

to be imposed in cases where the assessment year is 1974-75 or any earlier year ;

(2) two years from the end of the assessment year relevant to the previous year in respect of which liability to pay additional income tax arises in cases where the assessment year is 1975-76 or any later year ; or

(3) within one year from the end of financial year in which the assessment or reassessment of the profits and gains of the relevant previous year is made, *whichever is later.*

However the period of limitation, specified above, would not apply to cases where the company has made an application to the Central Board of Direct Taxes under Section 107A for a reduction in the amount of distributable income. Accordingly, the effect of the amendment is to reduce the period of limitation in relation to orders to be made under Section 104 for the assessment year 1975-76 and subsequent year from four years to two from the end of the relevant assessment year.

According to the decisions of the Supreme Court in *M.M. Parikh vs. Navanalgar Transport & Industries Ltd. (1967) 63 I T.R. 663* and *Pilani Investment Corporation Ltd. vs. ITO (1972) 83 I.T.R. 217* an order under Section 104 is not an order of assessment since the liability of the company to pay additional income tax arises "not from the charge created by the statue but from the order of "Income-tax Officer" Consequently. the time limits for completion of a assessment or reassessment specified in Section 153 of the Act do not apply to the passing of an order imposing additional income tax on a company. This is also because of the fact that Sections 104 to 106 dealing with the levy of additional income tax are self-contained and regulatory in themselves and there is no need to invoke the provisions of Section 153 for this purpose. However, the time limit specified in Section 166 shall not apply to a company which has made an application to the Central Board of Direct Taxes for reduction in the amount of minimum distribution. But Section 155 (7) could be invoked in appropriate cases to regard the case as one of rectification of mistakes for passing order under Section 104.

4. CAPITAL GAINS OF COMPANIES

Special Provisions :

(1) Where, the assets of a company are distributed to its shareholders in species on its liquidation such a distribution is *not* deemed to be a *transfer* made by company for purposes of capital gains tax. In the absence of this specific provision, the company would be deemed to have made capital gains on the assets transferred and would consequently be liable to tax in respect thereof [Section 46 (1)].

(ii) Where a shareholder receives any money or assets from a company on its liquidation, he is chargeable to tax under the head 'capital gains' in respect of the money or the market value of the assets on the date of distribttion, reduced by the amount of notional dividends, if any, assessed under Section 2 (22) (c) [Section 46 (2)].

Section 47 provides that the following transfers of capital assets will not be considered for the purposes of levying tax on capital gains under section 45.

(i) By a holding company to its Indian subsidiary company provided the former holds the whole of the share capital of the latter.

(ii) By a subsidiary compay to its Indian holding company provided the latter holds all the share capital of the former.

(iii) In a scheme of amalgamation, by the amalgamating company to its amalgamated Indian company.

Transfer of Capita: assets :

New Section 47A—Taxation Laws (Amendment Act, 1984 : The Taxation Laws (Amendment) Act 1984 has inserted a new section 47A with effect from 85-86 assessment year. This section provides for the withdrawal of the exemption in respect of capital gains in certain cases covered by (i) and (ii) above. The provisions of Section 47 (iv) provides that the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from capital gains tax levy. Similarly 47(v) exempts tranfer from subsidiary company to holding company. The only condition for such an exemption has been that the transferee company must be an Indian Company.

The new section provides that where the "transfer" of a capital asset between a parent company and its hundred per cent subsidiary company has been exempted from any charge to capital gains tax by virtue of the provisions of clause (iv) or (v) of section 47 such exemption will be revoked in either of the two undernoted cases by an order of rectification under section 155 (7A) of the Income Tax Act, 1961.

(i) Within a period of eight years from the date of the transfer the capital asset in question is converted by the transferee company into, or it as, stock-in-trade of its business ; or

(ii) Within a period of eight years from the date of the transfer the parent company or its nominees or, as the case may be, the holding company ceases or cease to hold the whole of the share capital of the subsidiary company.

Although Section 47A is effective from the assessment year 1985 86, it can have retrospective operation inasmuch as even if any transaction which had taken place in a previous year relevant to any of the assessment, year 1984 85, backwards to 1977-78, would now be liable to revision if any of the contingencies referred to in Section 47A take place now. In this sense it is retrospective in operation.

To give illustrations o. ...

follows :

A. Co, Ltd., holds 100 per cent shares of B. Co. Ltd., both being Indian companies. In the year 1982, the calendar year being the previous year of both companies. A Co, Ltd., tranferred to B Co. Ltd., a capital asset for a consideration of Rs. 50,00,000 the original cost of such asset being Rs. 10,00,000 in such a case, the capital gains of Rs. 40,00,000 would be exempt so far as the assessment year 1983-84 was concerned. Such exemption would be by virtue of section 47 (iv). If *now, in the year 1984, B. Co. Ltd converts the said asset into its stock in trade and the value as on the date of such conversion is Rs. 60,00,000, even though there is no present transfer in the normal sense. A. Co. Ltd would lose the benefit it had obtained under section 47 (iv) in its assessment for the assessment year 1983-84. By an order under section 155 (7A) as stated above, the income tax officer will have the right to revise the original assessment for the year 1983-84 at any time before December 31, 1988, so as to cancel the exemption from capital gains tax on the sum of Rupees Forty lakhs enjoyed by it earlier, In other words, for the assessment year 1983-84 the total income originally assessed will be enhanced by a sum of Rs. 40,00,000 being the amount of capital gains previously exempted under section 47 (iv), but now taxed under section 47A.*

A second case may be envisaged, where again X Co. Ltd, being a 100 per cent subsidiary company of Y Co. Ltd.. both being Indian companies, had transferred a capital asset which had cost it Rs. 5,00,000 to its parent company. Y. Co. Ltd, at Rs. 20,00,000 the fair market value of the asset in question being Rs. 20,00,000 on the date of the transfer. This transaction had taken place, say, in the year 1980, the calendar year being the previous year for both the companies in this case also. If now in the year 1984 Y. Co. Ltd disposes of a part of its holdings in X Co. Ltd. say, five per cent, only, the old relationship of Co. Ltd. being its 100% subsidiary would be lost. As a consequence, section 47A would require that the assessment for the assessment year 1981-82 should be rectified under section 155 (7A) so as to revoke the exemption from capital gains tax which was enjoyed by X. Co. Ltd., in respect of the capital gains of Rs, 15,00,000 which it had made on the transfer of capital asset to its parent company.

From these two examples it may be appreciated that although section 47A is effective from the assessment year 1985-86 any transaction which had taken place in a previous year relevant to any of the assessment year 1984-85 backwards to 1977-78 would now be liable to revision if any of the contingencies referred to in section 47A take place now. In this sense it can have retrospective effect in operation.

The other provisons relating to taxation of capital gains have been explained in Study Paper III

5. RESTRICTION ON CERTAIN DEDUCTIONS IN THE CASE OF CERTAIN COMPANIES

The Finance Act, 1983 has inserted a new Chapter VIB in the Income tax Act (Section 80 VVA) with effect from 1984-85 asst. year with a view to securing

... of tax concessions admissible under the Act do not result in reducing the taxable income of companies to the extent that no tax or only a negligible tax is paid by profit-making companies. Where in the case of companies the aggregate amount of deduction admissible under certain specified provisions of the Act exceeds 70% of the amount of total income computed before making such deductions, the amount to be deducted under these provisions will be restricted to 70% of the total income computed before making such deductions.

For the purpose of deductions to be allowed in respect of any tax incentive the priority of the deduction is to be detemined in the order in which the various incentives are listed in the Section. If any portion of any incentive cannot be set off against the pre incentive income of the company for any year, the same will be allowed to be carried over to subsequent years (without any time limit) and will form part of the relief due under the respective section in the subsequent years. In this process, deductions which are normally not allowed to be carried forward (e g. deduction u/s 80 G, 80-HH, 80-I, 80-M, 80-0 etc.) will now be allowed to be carried forward to the extent to which the benefit of deduction is otherwise allowable but is denied under this new section.

The items of incentives which are listed in the above section refer to the deductions allowed under the following sections :

(i) Contribution to scientific research association relating to business [Section 35 (i) (iii)].

(ii) Capital expenditure on scientific research [Section 35 (2) (ia)].

(iii) Weighted deduction for scientific research expenditure on an approved project [Section 35 (2A)].

(iv) Weighted deduction for in-house scientific research expenditure on approved projects [Section 35 (2B)].

(v) Agricultural development allowance (Section 35C).

(vi) Rural Development allowance (Section 35CC).

(vii) Contribution to institutions for rural development (Section 35CCA).

(viii) Contributions to institutions for programmes for conservation of natural resources (Section 35\ CB).

(ix) Unabsorbed Development rebate [Section 33 (2) (ii)].

(x) Unabsorbed Development Allowance [Section 33A (2) (ii)].

(xi) Current Year's Development Allowance [Section 33A (i), and 33A (2) (i)].

(xii) Unabsorbed Investment Allowance [Section 32A (3) (ii)].

(xiii) Current Year's Investment Allowance [Section 32A (1) and 32 A (3) (i)]

(xiv) Donations to Charitable Trust (Section 80G).

(xv) Donations for scientific research and rural development [Section 83GGA (2) (b)].

(xvi) Donations for scientific research and rural development [Section 80GGA (2) (c)].

(xvii) Income of industrial undertaking in backward area (Section 80HH).

(xviii) Income of small scale industry in rural area (Section 80HHA).

(xix) Profits and gains from projects outside India (Section 80 HHB).

(xx) Export Turnover benefit (Section 80 HHC).

(xxi) Income of new Industrial undertakings etc., (Section 80 I).

(xxii) Tax holiday benefit in case of new industrial undertakings etc. Sec. 80J

(xxiii) Profits of Live Stock breeding or poultry farming (Section 80JJ).

(xxiv) Dividends from Tax holiday profits u/s 80J (Section 80K).

(xxv) Inter-corporate dividends (Section 80M).

(xxvi) Dividends from Foreign Companies (Section 80N).

(xvviii) Royalties etc. from Foreign enterprises (Section 80-O).

(vxviii) Profits and gains from business of publication of books (Section 83 QQ).

An analysis of the above provisions show that a company which has carried forward losses and or which has unabsorbed depreciation of earlier years and/or which has large claim of current depreciation can still have 'nil' taxable income and will not be affected by Section 80 VVA.

5. SPECIAL PROVISIONS IN REGARD TO TAXATION OF COMPANIES

Amalgamation : The definition of the term *'amalgamation'* as contained in Section 2 (1A) facilitating the amalgamation of uneconomic company units, has been discussed in Study Paper I. Sections 32, 32A, 34, 35, 35A, 35D 35E, 43, 47, 49, 55 and 72A contain specific provisions in this regard. The important tax implications of any amalgamation are given below.

(a) Where a company transfers on amalgamation any building machinery, plant or furniture to the amalgamated company, at price less or more than the written down value of these assets, it would be neither liable to pay tax on the deemed profit nor entitled to claim any terminal allowance in respect of such transfer. In consequence, the value of these assets in the hands of the amalgamated company shall be taken to be their original cost as reduced by the depreciation actually allowed to the amalgamating company.

(b) The amalgamated company will be entitled to amortise the capital cost of assets acquired for scientific research, promotion of family planning, patents

or copyrights taken over by it from the amalgamating company and the unabsorbed portion of the preliminary expenses and mining expenses allowable to the amalgamating company.

(c) The amalgamating company will not be liable to any capital gains tax or to any gift tax in respect of the value of assets transferred by it to the amalgamated company. The exception from gift tax is however, subject to the provisions of Section 45 of the Gift-tax Act, 1958.

(d) The shareholders of the amalgamating company will not be liable to pay tax on the capital gains on shares in the amalgamated company allotted to them in lieu of their original shareholding wherever the transfer of shares is in connection with an amalgamation.

It is significant to note that all the above benefits would be avaliable only where the amalgamated company is an Indian Company.

(e) Except in cases covered by Section 72A (discussed in Study III) the unabsorbed depreciation and brought forward business losses of the amalgamating company become a capital loss immediately on amalgamation and the amalgamated company cannot carry forward any of these items which the amalgamating company would have otherwise been entitled. The same would be the position in respect of losses of the amalgamating company computed under the head 'capital gain'. It is worthy to note thet Section 72A contemplates transferee company as any company, not necessarily an Indian Company.

(f) The unabsorbed portion of development rebate, investment allowance and development allowance allowable to the amalgamating company can be carried forward and allowed to the amalgamated company within the eight year time limit. The amalgamated company must comply with the various requirements in regard to the sale or transfer of the assets and creation and utilisation of reserves. It is significant to note that benefit would be available even if the amalgamated company is not an Indian company. Any failure to comply with these requirements would result in the withdrawal of the development rebate or allowance previously allowed to it or the amalgamating company treating it as a case of rectification of mistake under Section 155.

(g) Amalgamation is a case of succession to business otherwise than by the death of the predecessor and consequently the provisions of Section 170 of the Income tax Act would apply to make the amalgamated company liable to pay the tax on the business income and also capital gains of the predecessor in respect of the year of succession and for the immediately preceding year. For details of the liabilities under Section 170 students may refer to the relevant discussion in Study Paper VI.

(h) Amalgamation does not, however, affect the accounting year of both the amalgamating and the amalgamated companies. If the amalgamation takes place during the accounting year, the income of the relevant accounting year must

be computed without taking into account the *factum* of *amalgamation* and the income so computed will be apportioned between the two companies and the total income of each of the companies will be computed after allowing the deductions and allowances permissible to each of them. T assessment of both the companies will have to be made separately and distinctly from one another although the amalgamated company itself may be made liable to pay the taxes of the amalgamating company.

(i) The various expenses in connection with the implementation of the scheme of amalgamation incurred by either of the companies would not be allowed as a deduction in computing their business income. This is because of the fact that these expenses have not been incurred by the companies in the ordinary course of their business. However, expenditure incurred in buying out shares of dissenting shareholder may be claimed as allowable expenditure since the expenditure facilitates better management and conduct of the business.

2. **Liability for Deduction of Tax at Source**: The principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends (including dividends on preference shares), within India, before making any payment in cash or before issuing any cheque or warrant in respect of any dividend – interim or final or before making distribution or payment to a shareholder falling within the definition of dividend in Section 2 (22) shall deduct from the amount of all such dividends, income tax at the rate or rates prescribed by the relevant Finance Act relating to the year in which the dividend was declared. The rates for deduction of tax at source have been specified in Part II of the First Schedule to the Finance Act, 1984 (Section 194).

Further, the liability of the company extends as well to the deduction of tax at source from salaries, interest on securities, interest other than interest on securities, payments to contractors or sub-contractors and other sums payable to non-residents in accordance with the provisions of the Section 192 to 206 B and Rules 26 to 37B of the Income-tax Rules 1962.

3. **Deduction/Tax Incentives applicable only to Companies**

1. Deductions from 'Interest on Securties' in the case of a banking company Section 20.

2. Initial Depreciation on a new hotel building owned by an Indian company – Section 32 (1) (v).

3. Deductions in the case of amalgamation of companies in respect of investment allowance, development rebate, development allowance, expenditure on scientific research and acquisition of patent rights or copy rights. unabsorbed losses and depreciation [Section 32A(6), 33(3), 33A(5), 35(5) 72A].

4. Export market development allowance (Domestic company and other resident assessees) (Section 3`B). This provision has got only a limited importance now.

5. Agricultural Development Allowance (Companies and Co-operative Societies) (Section 35C) : This provision has got only a limited importance now.

6. Rural Development Allowance (Companies and Co-operative Societies)—Section 35 CC.

7. Amortisation of preliminary expenses (Indian companies and other resident assessee – Section 35D).

8. Amortisation of expenditure on prospecting etc., for certain minerals (Indian companies and other resident assessees)-Section 35E.

9. Deduction in respect of special reserves created by approved housing finance companies [Section 36(1) (viii)].

10. Deduction in respect of expenditure incurred by a company for promoting family planning amongst its employees [Section 36(1) (ix)].

(11) Deduction from Gross Total Income in respect of profits and gains from new ships or hotel business owned by Indian companies and new industrial undertakings owned by any assessee including a company—Section 80J/Section 80I.

12. Inter corporate Dividends - Section 80M.

13. Royalties etc., received by an Indian company from Indian concern—Section 80MM. omitted w.e.f. 84-85 assessment year.

14. Dividends received by Indian companies from foreign companies in consideration of know how sales—Section 80N.

15. Royalties, etc. received by an Indian company from foreign enterprises for know how sales—Section 80O.

16. Tax on capital gains in the case of companies—Section 115.

17. Tax on foreign companies—dividends, royalties & technical fees Section 115A.

4. Provisions imposing restrictions on the deductibility of expenditure/Payments and having special significance to Companies

1. Restrictions on expenditure on advertisement, publicity and sales promotion etc. 37(3A) to (3D).

2. Expenditure on remuneration, benefit amenity to directors, substantial interest holders and their relatives—Section 40 (c).

3. Expenses or payments *covered by Section 40 (A).*
4. Head Office Expenditure in the case of non-residents—Section 44C.
5. Computation of income by way of r..alties, etc., in the case of foreign companies Section 44D.
6. Set-off of losses in the case of a company in which public are not substantially interested—Section 79.

5. **Tax Liability of a Company in Liquidation :** (Section 178): This has been discussed in Study Paper VI under the head 'Liability in Special Cases. The tax implications of liquidation in the context of taxation of capital gains have been explained in Study III and in the matter of dividends in Study 1.

6. **Liability of Directors of Private Companies in Liquidation :** Section 179 provides that when any private company is wound up and any tax is assessed on the company whether before or during the course of or after its liquidation in respect of its income of any previous year and it cannot be recovered from the company, then every person who was a director of company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax, penalty, interest or any other sum of money assessed on the company and remaining unpaid unless he proves to the satisfaction of the I.T.O. that the non recovery of the amounts cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section 179, provides for the collection and recovery of tax in the case of all private companies. According to the amended Section 179, the directors of a private company would be personally liable to pay the taxes due from the company not only at the time when the company is wound up but even in case where the company is not in liquidation. Thus, the directors of private company are jointly and severally liable for the payment of any tax due from a private company in respect of its income liable to tax in any accounting year or from any other company in respect of any income of any previous year during which time, such other company was a private company. In cases where private company is converted into a public company and the taxes assessed in respect of any income of any previous year during which such company was a private company could not be recovered from the company, then any tax due in respect of the income of private company could be recovered from any of the persons who were directors of the private company before it become a public company. However, such liability of the directors has been restricted to the taxes due in respect of the assessment years commencing on or after the 1st day of April, 1963. The directors would be in a position to get away from this personal liability to pay the taxes of the company, only if it could be proved that the non-recovery of the taxes due from the private company is not attributable to any gross negligence, misfeasance or breach of duty on their part in relation to the affairs of the private company. Thus

the personal liablity of the directors has extended to cases of private companies which are not in liquidation and those which might have subsequently become public companies.

Relief to certain charitable institutions and funds in repect of certain dividends : The provisions of Section 235A apply to charitable institutions or funds referred in Section 104(2) (iii). The institution or fund shall be allowed a tax credit as calculated in sub section (2) of Section 236A, in respect of its income from dividends (other than on preference shares) distributed during any previous year relevant to any assessment year beginning on or after 1.4 1966, by a company referred to in Section 104 (iii) viz , a company 75 per cent of whose shareholding throughout the relevant previous year is beneficially held by a charitable institution or fund in India the income from dividend of which is wholly exempt from tax under Section 11. The tax rebate to the institution or fund will be calculated as follows :

$$\text{The amount of tax payable by the company with reference to the relevant amount of distribution of dividends.} \times \frac{\text{Dividend (other than on preference shares received by the funds of institution)}}{\text{Total dividends (other than on preference shares) declared by the company.}}$$

8. Carry forward and set off of losses incurred by closely-held companies : Section 79 applies only in cases where a change in shareholding has taken place in the case of a company in which the public are not substaintially interested. Such companies will be entitled to the benefit of carry forward and set off of any earlier year's losses in the following previous year *only if*—

(i) on the last day of the previous year shares carrying not less than 51% of the total voting power are beneficially held by persons who beneficially held those shares on last day of the previous year in which such loss was incurred ; or

(ii) the I.T.O. is satisfied that the change in the shareholding was not brought about with a view to avoiding or reducing tax liability.

Thus, it is the motive and not only the effect of the change in holding which is material for this purpose. The object of the Section is to counter avoidance of tax by person taking advantage of the corporate personality of the company. The Section does not, however, affect the right of the company to set off its current losses against other current income nor does it affect the carry forward of unabsorbed depreciation allowance, development rebate, or investment allowance, expenditure on scientific research, patents or copyright, and expenses on the prospecting or the extraction of any mineral or group of associated minerals subject, however, to the other provisions of the Act for the carry forward and set-off of these items.

9. **Tax Credit Certificates**: *The benefit of tax credit certificates for shifting industrial undertakings from u n areas under Section 280ZA is available* to companies. These have been discussed in Study VII.

10. **Prescribed Arrangements for the Declaration and payment of Dividends within India**: These arrangements (specified in Rule 27 of the Income-tax Rules) are the following:

(i) The share register of the company concerned for all its shareholders shall be maintained regularly at its principal place of business within India in respect of any assessment year from a date not later than the 1st day of April of each assessment year.

(ii) The annual general meeting of the shareholders for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.

(iii) The dividends declared, if any, shall be made payable only within India to all the shareholders.

It is obligatory for Indian companies to make the prescribed arrangements stated above; non-Indian companies will be treated as domestic companies only if they make the prescribed arrangements for the declaration and payment of dividends in India.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL

F.S.P.1. Tax—7

FINAL COURSE

INCOME-TAX

STUDY—VII

Contents :

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6. Mode of acceptance, Payment or repayment of certain loans and deposits Tax credit certificates.
7. Miscellaneous provisions.
8. Public Provident Fund Scheme.

Prescribed Readings : *Indian Income-tax Law & Practice.* by Sukumar Bhattacharya (Latest Edition)

1. SETTLEMENT OF TAX CASES (Sections 245A to 245M)

These provisions are primarily based upon the recommendations of the Direct Taxes Enquiry Committee headed by the former Chief Justice of the Supreme Court, Shri K.N. Wanchoo.

According to Section 245B, the Central Government is empowered to constitute a commission known as the Income-tax Settlement Commission for the settlement of income-tax cases. It also provides that the Settlement Commission shall consist of a Chairman and two other members and shall function within the Department of the Central Government dealing with direct taxes.

It may be noted that the effect of the above provision is that Settlement Commission can be rendered temporarily idle if the vacancy of its members is not filled immediately. With a view to overcoming the difficulty the Finance Act 1982 has inserted a new section 245B (2A). Accordingly when the post of one of the other members of the Settlement Commission is vacant for any reason, the Chairman and the other members of the Settlement Commission may function as, and exercise and discharge the powers and functions of the Settlement Commission under this Chapter. If in any case the Chairman and member so functioning differ on any point or points, they shall state the point or points on which they differ and refer the same as soon may be after the said vacancy is filled to the member appointed to fill the vacancy for hearing on such point or points and such points or points shall be decided according to his opinion.

The Chairman and other members of the Settlement Commission are to be appointed by the Central Government from amongst persons of integrity and outstanding ability having special knowledge of and experience in problems relating to direct taxes and business accounts. In cases where a member of the Central Board of Direct Taxes is appointed as the Chairman or as a member of the Settlement Commission, he would cease to be a member of the Board. Until permanent members are appointed by the Central Government, the Government is empowered to require, from time to time, any two members of the Board to serve as members of the Settlement Commission for such period or periods as the Government thinks fit, in addition to their duties as member of the Board.

For purposes of settlement of cases, the terms "*case*" has been defined Section 245A to mean any proceeding under the Income-tax Act, 1922 or under the Income-tax Act 1961 for or in connection with the assessment or reassessment of any person in respect of any year or years, which may be pending before Income-tax authority on date on which an application under Section 245-C (1) made for the settlement of the case.

Under Section 245-C the assessee is entitled, at any stage of a case relat to him, to file an application in the prescribed form containing the particulars to prescribed by the Central Board of Direct Taxes for the purpose of settlement his case. The application must be filed with the Settlement Commission and m be accompanied by the prescribed fee. The application of the assessee is the stage in the process of settlement of tax cases under the Income-tax Act. When o an application is filed, the assessee is not entitled to withdraw the same for reason.

On receipt of an application from the assessee, the Settlement Commis shall call for a report form the Commissioner of Income-tax and on the bas

the materials contained in the report and having due regard to the nature and circumstances of the case of the complexity of the investigation involved therein, the Settlement Commission may pass an order either for allowing the application to be proceeded with or for rejecting the same. However, in cases where an application for settlement of a case is sought to be rejected, the rejection should not be made unless a reasonable opportunity has been given to the applicant for being heard. Where an order is passed allowing the application to be proceeded with or for rejecting the application of the assessee, the order must be sent both to the applicant and to the Commissioner. However, an application for settlement of a case should not be proceeded with in cases where the Commissioner of Income-tax objects to the application being proceeded with by the Settlement Commission on the ground that concealment of particulars of income on the part of the applicant or perpetration of fraud by him for evading any tax or other sum chargeable under the income-tax Act or any fine or penalty imposable has been established or is likely to be established by any Income-tax authority in relation to the case. The expression "*Income-tax authority*" as used in this context must be taken to mean a Director of Inspection, a Commissioner of Income-tax, a Commissioner (Appeals) an Appellate Assistant Commissioner and an Inspecting Assistant Commissioner or an Income-tax Officer.

Section 245D has also empowered the Settlement Commissioner to review the objections raised by the Commissioner of Income-tax and, in cases where the objections are sought to be over-ruled, to provide an opportunity to the Commissioner to be heard and then proceed with the settlement of the case for which an application is made by the assessee.

In cases where an application is allowed to be proceeded with, the Settlement Commission may call for the relevant records from the Commissioner, and after examination of such records, if it is of the opinion that any further enquiry or investigation in the matter is necessary, the Commission may direct the Commissioner to make or cause to be made such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter which may be relevant in the case. After examination of the various records and the reports of the Commissioner, and after giving the applicant and also the Commissioner an opportunity of being heard, either in person or through a representative duly authorised in this behalf, and after examination of such further evidences as may be obtained or placed before the Settlement Commission, the Commission may pass such orders as it thinks fit in accordance with the provisions of the Income-tax Act on the various matters covered by the application and also any other matter relating to the case which may not have been covered by the application, but referred to in the report of the Commissioner. The provisions are contained in Section 245-D.

Before passing any order and subject to the provisions of Section 245B (2A) as explained in the beginning, the various materials brought on record before the Settlement Commission must be considered by all the members of the Commission and in cases where there is any difference of opinion among the members, the opinion of the majority shall prevail and the order of the Settlement Commission must also be expressed in terms of the views of the majority. All the orders passed by the Settlement Commission under Section 245D(4) must provide for the terms of the Settlement including any demand by way of tax, penalty or interest,

the manner in which any amount due as a result of the settlement should be paid and all other matters which are essential to make the settlement of the case effective. The order should also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that the settlement order was obtained by fraud or any misrepresentation of facts by the applicant. In cases where the settlement becomes void, the proceeding, in respect of which the settlement order was passed, must be deemed to have been received from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the Income-tax authority concerned may complete the proceedings for assessment or reassessment of income or the levy of pena , fine. etc. at any time before the completion of two years from the end of the financial year in which the settlement becomes void would be applicable notwithstanding the fact that the time-limit and also the procedure for completion of assessment, reassessment, etc. contined in any other provision of the Act are different.

If the Settlement Commission is of the opinion that for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceeding connected with the case, but which has been completed under the Indian Income-tax Act, 1922 or under Income-tax Act, 1961 by any Income-tax authority before the application of the assessee under Section 245C was made, it may, with the concurrence of the applicant, reopen such proceedings and pass such orders thereon as it deems fit as if the case in relation to which the application for the settlement had been made by the applicant covered the proceedings for reopening of assessments as well. Before initiating the proceedings for reopening of assessment in any case, the reasons for arriving at the opinion for such reopening of the assessment must be recorded by the Settlement Commission. However, no proceeding for assessment, re-assessment, etc. could be reopened by the Settlement Commission under Section 245-E after the expiry of a period of 8 years from the end of the assessment year to which the proceedings relate. In other words, the time limit for reopening of any last assessment proceedings by the Settlement Commission has been specifically restricted to eight years (Section 245-E).

The Settlement Commission has been vested with all the powers which are vested in an Income-tax authority under the Income-tax Act. In addition, special powers also have been granted to the Settlement Commission for the purpose of Settlement of Tax Cases. Accordingly, in cases where an application made by the assessee under Section 245-C has been allowed by the Settlement Commission to be proceeded with under Section 245-D, the Settlement Commission is empowered to exercise exclusively the jurisdiction and powers and perform the functions allotted to an Income-tax authority under the Income-tax Act until an order for settlement of the case is passed. However, in the absence of any express direction to the contrary by the Settlement Commission, the operation of any other provision of the Income-tax Act requiring the applicant to pay the tax on the basis of self-assessment or by way of advance-tax shall continue to be applicable in relation to matters which are before the Settlement Commission for consideration. Further in the absence of any express directions by the Settlement Commission to the contrary, the provisions of Sections 245-A to 245-M would not affect the operation of any other provision of the Income-tax Act insofar as those provisions relate to any matters other than those covered by the case before the Settlement Commission. Like the Income-tax Appellate Tribunal the Settlement Commission also has got powers to regulate its own procedures including the fixation of places

and timings for its meetings and may act in accordance with the provisions specifically contained in Chapter XIXA and the rules laid down in the procedure notwithstanding the fact that all the members of the Settlement Commission are not present at any of its meeting. These powers of the Settlement Commission are contained in Section 245-F.

According to Section 245-G, no person is entitled to inspect or obtain copies of any reports made by any Income-tax authority to the Settlement Commission in relation to the case, but, the Settlement Commission may, at its discretion, furnish copies thereof to any person on receipt of an application made to it in this behalf and on payment of the prescribed fee. However, in order to enable any person whose case is under consideration to rebut any evidence which has been brought on record against him in any such report, the Settlement Commission shall, on receipt of an application in this behalf and on payment of the prescribed fee, furnish to the applicant, a certified copy of any such report or particular thereof which may be relevant for the purpose.

The Settlement Commission may, if it is satisfied that any person who made the application for settlement under Section 245-C has co-operated with the Settlement Commission in the conduct of the proceedings before it and has made a true and full disclosure of his income, and the manner in which such income has been derived, grant to such person immunity from prosecution for any offence under the Income-tax Act or under the Indian Penal Code or under any other Central Act which is for the time being in force. Such an immunity may also be granted in the matter of imposition of any penalty under the income-tax Act in respect of the case which is covered by the settlement. The power of the Settlement Commission to grant immunity from prosecution and the imposition of penalty is, however, subject to such conditions as the Commission may think fit to impose in the circumstances of the case. An immunity granted by the Settlement Commission to any person may, at any time, be withdrawn by it in cases where it is satisfied that the person concerned has not complied with the conditions subject to which the immunity was granted or where the person had, in the course of the settlement proceedings concealed any particulars or had given false evidence and thereupon the person concerned may be tried for the offence with respect to which the immunity was granted or for any other offence in respect of which he has been found guilty in connection with the settlement. After the withdrawal of the immunity from prosecution, the person concerned may also become liable to the imposition of the penalty under the Income-tax Act to which he would otherwise have been liable in the absence of the immunity given to him (Section 245-H).

Section 245-I provides that every order of the Settlement Commission passed under Section 245-D (4) shall be conclusive in respect of the matters contained therein and consequently no matter covered by the settlement order shall be liable to be reopened in any proceeding under the Income-tax Act or under any other law for the time being in force except, however, in those cases wherein the reopening of the case is specifically provided under Section 245-D (7).

According to Section 245-J, any amount specified in an order of settlement passed by the Settlement Commission under Section 245-D (4), may be recovered and any penalty for default in making the payment may be imposed and recovered from the person concerned in accordance with the provisions of the Income-tax Act. This power for making the recovery of the tax and for imposition of any

penalty is subject, however, to such conditions, if any, as may be specified by the Settlement Commission in the order passed by it. The right of recovery may be exercised by the Income-tax Officer having jurisdiction over the person who has made the application for settlement under Section 245-C.

An assessee, who has once got his case settled by the Settlement Commission, is debarred from making a subsequent application for settlement in certain cases under Section 245-K. Accordingly, in cases where—(i) an order of settlement passed under Section 244-D (4) provides for the in sition of penalty on the person who has made the application for settlement, on the ground of concealment of particulars of his income ; or (ii) after the passing of an order of settlement, the applicant is convicted of any offence under the Income-tax Act in relation to that case, then he shall not be entitled to apply for settlement under Section 245-C in relation to any other matter.

All the proceedings under the Income-tax Act before the Settlement Commission shall be deemed to be judicial proceedings within the meaning of Sections 193, 196 and 228 of the Indian Penal Code.

Tax payers who have filed appeals to the Appellate Tribunal are also entitled to make an application under Section 245-M to the Settlement Commission for settlement of their cases. Accordingly, any assessee, who has filed an appeal to the Appellate Tribunal under the Income-tax Act which is pending before it, would be entitled to make an application to the Settlement Commission to have his case settled by it after he has withdrawn his appeal from the Appellate Tribunal and file an application to the Settlement Commission in cases where the Commissioner of Income-tax has directed the Income-tax Officer to file an appeal to the Tribunal under Section 253 (2) on the basis of an order in appeal passed by the Appellate Assistant Commissioner under Section 154 or Section 250. Where an assessee intends and is permitted by the law to file an application for settlement of the case, he should make an application to the Appellate Tribunal for withdrawing of the appeal. On receipt of an application from the assessee, the Appellate Tribunal shall grant permission to the assessee to withdraw his appeal and upon the withdrawal of the appeal, the proceedings in appeal immediately before the withdrawal must, for purposes of settlement, be deemed to be a proceeding pending before an Income-tax authority. An application for settlement of a case which was filed before the Tribunal should be made within a period of 30 days from the date on which the order of the Tribunal permitting the withdrawal of the appeal is communicated to the assessee concerned. If an application is filed as a result of the withdrawal of an appeal from the Tribunal, such an application to the Settlement Commission must also be deemed to be an application made by the assessee under Section 245-C, and accordingly of the provisions relating to the settlement would be applicable. In cases where an application made by the assessee to the Settlement Commission under Section 245-M is not entertained by the Settlement Commission, then the assessee would not be deemed to have withdrawn the appeal from the Appellate Tribunal and consequently all the provisions for hearing of the case and passing of the order after complying with the necessary procedures by the Appellate Tribunal would, to the extent necessary, be applicable to the case. The assessee would in such a case be permitted to go ahead with proceedings in appeal before the Tribunal as if he had not made an application to the Settlement Commission.

Since the order of the Settlement Commission is conclusive and final in nature, the assessee or the department would not be entitled to refer the case to

the High Court for reconsideration as in the other cases where a reference on the basis of the order of the Appellate Tribunal is permissible to the High Court and then to the Supreme Court on questions of law.

2. APPEALS, REFERENCES AND REVISION (Sections 246 to 249)

The assessee is given a right of appeal by the Act where he feels aggrieved of the order of the assessing authority. But the assessee has no inherent right of appeal unless the statute specifically provides that a particular order is applicable. The right of appeal the A.A.C. is given to the assessee under Section 246 against the various orders of the I.T.O. specified in that Section ; the Department cannot appeal to the A.A.C. against the order of the I.T.O. though the Commissioner is empowered to revise the order of the I.T.O. under Section 263 if they are prejudicial to the Revenue. If the assessee is not satisfied with the orders of the A.A.C. he can proceed to make a further appeal to the Appellate Tribunal under Section 253. The I.T.O. may also appeal to the Tribunal under the directions of the Commissioner against any order of the A.A.C.

(A) Appeals to Appellate Assistant Commissioners (Sections 246 to 269) : Section 246 confers upon an aggrieved assessee the right of appeal to the Appellate Assistant Commissioner of Income-tax against the following orders passed by the Income-tax Officer.

(i) an order against the assessee being a company in which the public are not substantially interested under Section 104 imposing additional income-tax on its undistributed profits ;

(ii) an order under Section 131 (2) imposing a fine on any person for not complying with the summons issued to attend office or to give evidence ;

(iii) an order against the assessee, where he denies his liability to be assessed or any order of assessment under Section 143 (3) or Section 144 where he objects to the amount of income or taxes assessed or the amount of loss computed or to the status under which he is assessed ;

(iv) an order under Section 146 passed by the Income-tax Officer refusing to reopen an *ex parte* assessment made under Section 144 ;

(v) an order of assessment or re-assessment or recomputation under Sections 147 and 150 ;

(vi) an order of rectification under Section 154 or Section 155 having the effect of enhancing the assessment or reducing a refund or an order refusing the claim for rectification made by the assessee under either of the said Sections ;

(vii) an order made under Section 163 treating the assessee as an agent of a non-resident person ;

(viii) an order under Section 170 making an assessment on the successor to a business in respect of the income earned by the predecessor ;

(ix) an order under Section 171 refusing to recognise the partition of a Hindu undivided family ;

(x) an order refusing to register a firm under Section 185 ;

(xi) an order cancelling the registration of a firm under Section 186 ;

(xii) an order under Section 201 lavying penalty on a company on its failure to deduct tax at source in respect of dividends or after deducting, failure to pay the tax in all cases where it is required to do so.

(xiii) an order made under Section 216 levying penal interest on an assessee in case of advance tax payable by him ;

(xiv) an order under Section 237 refusing to ant refund ; and

(xv) an order imposing penalty under any of the Sections 140-A, 221, 270, 271, 272 and/or 273.

(xvi) an order imposing penalty by the Income-tax Officer under Section 271-A of the Income-tax Act in a case where the assessee has been charged with failure to keep and maintain such books of accounts and other documents as are prescribed under the Income-tax Act ;

(xvii) an order passed by the Income-tax Officer imposing penalty under Section 271 B in case where the assessee is charged with failure to comply with the provisions of Section 139-A in the matter of permanent account numbers.

Appeals to Commissioner (Appeals)

Sub-section (2) of Section 246 of the Income-tax Act provides that an appeal will lie to the Commissioner of Income tax (Appeal) against any of the following orders ; *viz.*,

(i) Any order specified in clauses (b) to (h) (both inclusive) and clauses (l) to (o) (both inclusive) of Section 246 (l) or an order in respect of liability to additional income-tax passed under Section 104 in the case of any closely-held company for its failure to distribute the statutory percentage of its distributable income as dividend within the meaning of Section 2 (22) of the Income-tax Act. [In this context it may be noted that by virtue of the provisions contained in Section 107A(9), as amended by the Finance Act (No. 2) of 1977, no appeal would lie to the Commissioner (Appeals) against any order passed under Section 104 in cases where a decision has been taken by the Central Board of Direct Taxes and the decision is communicated to the assessee under Section 107A].

(ii) Any order relating to assessments, re-assessments, registration of firms, rectification of mistakes etc. specified in clauses (c) to (o) of Section 246(l) where such order is passed by the Inspecting Assistant Commissioner in exercise of the powers conferred on him under Sections 125 and 125A.

(iii) Any order passed by the Inspecting Assistant Commissioner imposing fine on the assessee under Section 131(2).

(iv) An order of assessment made by the Income-tax Officer on the basis of directions issued by the Inspecting Assistant Commissioner under Section 144B.

(v) Any order imposing penalty in respect of income which has escaped assessment as a result of the assessee's failure to furnish correct and complete information in regard to the amount of income assessable to tax as a result of which the order for imposition of penalty is passed under Section 271 (l) (c) where the order for imposing penalty has been passed after obtaining the prior approval

of the Inspecting Assistant Commissioner as required under the Provision of Section 271(1)(iii).

(vi) an order made by the Inspecting Assistant Commissioner imposing penalty under Section 272A for the failure to answer questions, sign statement, allow inspection etc.

(vii) An order passed by the Income-tax Officer under the Income-tax Act in the case of such persons or classes of persons as the Central Board of Direct Taxes may, having due regard to the nature of the cases the complexities involved and other relevant considerations, direct.

Sub-section (4) of Section 246 provides that every appeal against an order specified in clauses (b) to (h)—both inclusive—and clauses (i) to (o)—both inclusive—of sub-section (1) of Section 246, in the case of a company pending immediately before 1st June, 1979 before an Appellate Assistant Commissioner and also any matter arising out of or connected with such appeal and which is so pending must be transferred from that day to the Commissioner (Appeals) who is empowered to proceed with such appeal or matter from the stage at which it was on that date. However, the appellant would have the right to demand that before proceeding with the appeal the previous proceeding or any part thereof may be reopened or that he may be reheared. Further, the Central Board of Direct Taxes has been empowered under sub-section (5) to transfer any appeal which is pending before an Appellate Assistant Commissioner and any matter arising out of or connected with such appeal and which is so pending to the Commissioner (Appeals) if the Board is satisfied that it is necessary or expedient so to do having regard to the nature of the case, the proceedings involved and other relevant considerations After the appeal is so transferred the Commissioner (Appeals) would be empowered to proceed with such appeal or matter from the stage at which it was before the transfer. The appellant would, however, have the right even in such a case to demand that, before proceeding further with the appeal or matter the previous proceeding or any part thereof may be reopened or that he may be reheard.

Appeals by a Partner (Section 247) : Any partner of a firm, who is assessable on his share in the total income of the firm may also appeal to the Appellate Assistant Commissioner of Income tax or as the case may be Commissioner (Appeals) against any order of the Income-tax Officer determining the amount of total income or loss of the firm or the apportionment thereof between the several partners. But he cannot agitate against such matters in any appeal preferred with respect to the assessments of his own total income or the loss assessed.

Appeals by a Person denying his Liability to deduct Tax (Section 228) : Any person who denies his liability to make a deduction of tax at source in accordance with the provisions of Sections 192 to 195 of the Act may also appeal to the appellate Assistant Commissioner of Income-tax or, as the case may be, the Commissioner (Appeals) to be declared that he is not liable to make any such deduction.

Form of Appeal and Limitation (Section 249) : An appeal to the Appellate Assistant Commissioner of Income-tax or, as the case may be Commissioner (Appeals) against any of the orders which is appealable is to be presented within thirty days from the date specified below in the particular cases. However, the

Appellate Assistant Commissioner or, as the case may be Commissioner (Appeals) may admit an appeal even after the expiration of the said period of thirty days, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within the specified time. The dates from which the limitation period of thirty days has to be reckoned are as follows :

(i) the date of service of notice of demand where the appeal relates to any assessment or penalty ; or

(ii) the date of payment of tax where the appeal relates to any tax deducted at source from payment to non-residents under Section 195(1) ; or

(iii) in any other cases, the date on which intimation of the order sought to be appealed against is served.

Different forms of appeal have been prescribed for filing appeals against different orders. Rules 45 and 46 of the Income-tax Rules, 1962 deal with the form of appeal (Form No. 34) signature on the form of appeal and the mode of service of the appellate order.

Section 249(2) (b) provides that the appeal to the Appellate Assistant Commissioner which should normally be filed within 30 days from the date of receipt of the Income-tax Officer's order relating to any assessment or the levy of any penalty should, however, be relaxed in cases where an application has been made by assessee under Section 146 to the Income-tax Officer for the reopening of the assessment. Accordingly, in all cases where an application for reopening of assessment has been made by the assessee, the time-limit of filing the appeal to the Appellate Assistant Commissioner should be calculated by excluding the period from the date on which the application to the Income-tax Officer under Section 146 is made till the date on which the order passed on the application by the Income-tax Officer is served on the assessee. Thus, the time taken by the Income-tax Officer for the disposal of any application for reopening of assessment would be excluded in determining the time limit within which the appeal to the Appellate Assistant Commissioner should be filed.

No appeal to the Appellate Assistant Commissioner or, as the case may be, Commissioner (Appeals) shall be admitted for consideration unless, at the time of filing the appeal, the assessee has paid the tax due on the amount of income returned by him in cases where a return has been filed by the assessee. If, however, no return has been filed by the assessee and an assessment has been made on him by the Income-tax Officer, then the assessee must pay an amount equal to the amount of advance tax which was payable by him before filing the appeal. The Appellate Assistant Commissioner or, as the case may be, Commissioner (Appeals) is, however, empowered to exempt an appellant from the operation of this requirement on receipt of an application from the appellant made specifically for this purpose, giving the reasons for the non-payment of the tax. The concerned authority is also required to pass an order in writing while granting the exemption indicating also the reasons on account of which the exemption is granted to the assessee.

Procedure in Appeal (Section 250) : On receipt of an appeal the A.A.C. or, as the case may be Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the assessee and the I.T.O. against whose order the appeal is made. Both the assessee and the I.T.O. have the right to be heard at the hearing of the appeal either in person or by an authorised representative.

The Appellate Assistant Commissioner or, as the case may be, Commissioner (Appeals) before passing an order on an appeal, may make such further enquiries as he thinks fit or direct the Income-tax Officer to make further enquiries and report the same to him. He may also allow the appellant to go into any grounds of appeal not specified previously by the appellant if he is satisfied that the omission of that ground was not wilful or unreasonable.

The order of the A.A.C. or, as the case may be, Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. On disposal of the appeal the A.A.C. or, as the case may be, Commissioner (Appeals) must communicate the order passed by him to the assessee as well as the Commissioner.

Powers of the Appellate Assistant Commissioner or the Commissioner (Appeals) (Section 251): While disposing of an appeal the A.A.C. or the Commissioner (Appeals) is vested with the following powers *viz.*

(i) In an appeal against an order of assessment, he may confirm, reduce, enhance or annual the assessment; he may also set aside the assessment and refer the case back to the I.T.O. for making a fresh assessment in accordance with the directions given by him to the I.T.O. The I.T O. shall, on making a fresh assessment as required by the A.A.C., or, as the case may be Commissioner (Appeals) after such further enquiries as may be necessary, determine the amount of tax payable on the basis of such fresh assessment.

(ii) In an appeal against an order imposing a penalty he may confirm or cancel such order or vary it in such a way as to enhance or reduce the penalty.

(iii) In any other case the A.A.C. or, as the case may be Commissioner (Appeals) may pass such orders in the appeal as he deems fit.

The A.A.C., or, as the case may be Commissioner (Appeals) however, is not empowered to enhance an assessment or a penalty or to reduce a refund due to the assessee without giving the assessee a reasonable opportunity of showing cause against such an enhancement or reduction. In disposing of an appeal, the A.A.C. or, as the case may be, Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed even if such matters were not raised before the A.A.C. or, as the case may be Commissioner (Appeals) by the appellant.

(A) Appeals to the Appellate Tribunal (Sections 252 to 255): The constitution of the Appellate Tribunal, as contained in Section 252, has already been discussed in the beginning of the study paper.

Under Section 253 an assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against :—

(i) an order passed by the Appellate Assistant Commissioner or, as the case may be, Commissioner (Appeals) in appeal under Section 250; or an order imposing fine passed by him at the original stage under Section 131 (2) or Section 154 or Sections 271-A and 272-A.;

(ii) an order imposing penalty passed by an Inspecting Assistant Commissioner under Section 15 or and 272-A.

(iii) an order passed by the Commissioner in revision under Sections 263 or 272-A or under Sections 154 and 285-A.

The Commissioner is also given the right of appeal to the Tribunal, if he objects to any order passed by any Appellate Assistant Commissioner or, as the case may be, Commissioner (Appeals) under Section 250.

Every appeal to the Appellate Tribunal has to be filed within *sixty* days from the date on which the order sought to be appealed against is communicated to the assessee or the Commissioner, as the case may be. However, the Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross objection even after the expiry of the said period of 60 days, if he is satisfied that there was sufficient cause for not presenting it within that period. The Act vests in the respondents in every appeal filed before the Tribunal a right to file a memorandum of cross objections against any part of the order of the Appellate Asststant Commissioner or, as the case may be, Commissioner (Appeals) within thirty days of the notice of the appeal and such memorandum is to be disposed of by the Appellate Tribunal as if it were an appeal. The appeal and the memorandum of cross objections to the Tribunal are to be in the prescribed form, and have to be accompanied by a fee of Rs. 200 where the appellant is the assessee. Rule 47 (2) of the Income-tax Rules 1962 deals with the form of appeal (Form No 36) and the memorandum of cross objections. (Form No. 36A). The Appellate Tribunal may, after giving both the parties to the appeal reasonable opportunity of being heard, pass such orders on any appeal as it thinks fit.

The Appellate Tribunal may, at any time within a period of four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it. However, if the mistake is brought to its notice by the assessee or the I.T.O., the Tribunal is bound to rectify the same. In cases where the amendment has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, the Tribunal shall not pass any order of amendment *unless* it has given notice to the assessee of its intention to do so and has allowed him a reasonable opportunity of being heard. The Tribunal must send a copy of any orders passed by it to the assessee and to the Commissioner. On all questions of fact the orders passed by the Appellate Tribunal on appeal shall be final and binding on the assessee as well as the Department (Section 254).

The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of Tribunal from amongsst the members' thereof. Ordinarily, a Bench shall consist of one judicial member and one accountant member. However, the President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the I. T. O. in the case does not exceed Rs. 40,000. The President may, for the disposal of any particular case, constitute a special Bench consisting of

of three or more members, one of whom must necessarily be a judicial member and one an accountant member.

If the members of a Bench differ in opinion on any point the point shall be decided according to the opinion of the majority, if there is a majority. But if the members are equally divided they should state the points on which they differ and the case shall be referred by the President of the Tribunal for hearing on such point by one or more of the other members of the Tribunal ; then, such points shall be decided according to the opinion of the majority of the members of the Tribunal who have heard the case, including those who first heard it.

The Appellate Tribunal is empowered to regulate its own procedure and the procedure of its Benches in all matters arising out of the exercise of its powers of the discharge of its functions, including the places at which the Benches shall hold their sittings. The Tribunal is vested with all the powers which are exerciseable by Income-tax authorities under Section 131 for the purpose of discharging its functions. Any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding for the purposes of the Income-tax Act and the Indian Penal Code and the Appellate Tribunal shall be deemed to be a Civil Court for all the purposes of the Income-tax Act and the Code of Criminal Procedure, 1898.

(C) **Reference to the High Court** (Section 256 to 260):

The assessee or the Commissioner is entitled within *sixty* days of the date on which he is served with a copy of the order of the Tribunal, to require the Tribunal to refer to the High Court any question of law arising out of the order of the Tribunal. For this purpose the assessee should make an application in the prescribed from (Form No. 37) under Rule 48 verified in the prescribed manner. If the application is made by the assessee, it should be accompanied by a fee of Rs. 200. The Appellate Tribunal shall draw up a statement of the case and refer to the High Court within 120 days of the receipt of the assessee's or the Commissioner's application. However, the Tribunal may, if it is satisfied that the applicant was prevented by sufficient cause from presenting the application within the sixty days aforesaid, allow the application to be presented within a further period of thirty days.

The Tribunal, on receipt of an application from the assessee or the Commissioner, is also entitled to refuse to state the case to the High Court on the ground that no question of law arises from the case. In such a case the assessee or the Commissioner, as the case may be, may, within six months from the date on which he is served with a notice of such refusal by the Tribunal, apply to the High Court. The High Court may, if it is not satisfied with the correctness of the decision of the Tribunal, require the Tribunal to state the case and to refer it. On receipt of such a requisition from the High Court the Tribunal is bound to state the case and refer it accordingly. In cases where the Tribunal refuses to refer a case to the High Court on receipt of an application by the assessee, the assessee may, within thirty days of receiving notice of such refusal, withdraw his application and if he does so, fee paid by him shall be refunded.

If on receipt of an application the Appellate Tribunal is of the opinion that, on account of a conflict in the decision of the High Court in respect of any particular question of law, it is expedient that reference should be made direct to the Supreme Court the Tribunal may draw up a statement of the case and refer it through its President direct of the Supreme Court. If the High Court or the Supreme Court is not satisfied that the statement in a case referred to it enable it to determine the question raised thereby, the Court may refer the case back to the Tribunal for the purpose of making such additions thereto or alterations therein as it may direct in this regard.

Any case referred to the High Court shall be heard by a Bench of not less than two Judges of the Court and shall be decided in accordance with the opinion of such judges or of the majority, if any, of them. Where there is no such majority the judges shall state the point of law upon which they differ and the case shall be then heard upon that point only by one or more of the other judges of the High Court and such points shall be decided according to the opinion of the majority of the judges who have heard the case including those who first heard the same. The High Court, or the Supreme Court upon hearing any case, shall decide the questions of law raised therein and shall deliver its judgment thereon containing the grounds on which such decision is founded. A copy of the judgment shall be sent under the seal of the Court and the signature of the Registrar to the Appellate Tribunal which shall pass such orders as are necessary to dispose of the case in conformity with the judgment. The cost of any reference to the High Court or the Supreme Court (excluding the fee for making the reference) shall be decided at the discretion of the Court.

(D) Appeals to the Supreme Court (Sections 261 to 269) :

If the High Court certifies a case to be a fit one for appeal to the Supreme Court, the assessee or the Department as the case may be who feels aggrieved by the order of the High Court, may proceed to make an appeal to the Supreme Court. The questions before the Supreme Court in appeal would simply be whether the question referred to the High Court has been correctly answered ; the Supreme Court would not go beyond the question or consider matters outside its limits. The High Court would certify a case as a fit one for appeal and grant leave for appeal to the Supreme Court if a substantial question of law is invovled or if the question is likely to occur in successive years, or if the question is otherwise of great public or private importance. An application for a certificate of fitness for appeal to the Supreme Court shall be made to the High Court within sixty days from the date of the High Court's judgment. But the time taken in obtaining a certified copy of the judgment should be excluded for computing the period of sixty days within which the application should be made to the High Court. But there is no right of appeal to the Supreme Court from the judgment of a High Court on a reference made to it in its advisory jurisdiction not falling under Section 256. If the High Court refuses to certify a case as being a fit one for appeal to the Supreme Court under Section 261, an application may be made to the Supreme Court, for special leave to appeal from the High Court's decision but not from the Tribunal's decision except in special circumstances. The Supreme Court may grant to the Commissioner special leave to appeal on his undertaking to pay the costs to the assessee in any event.

The right of appeal to the Supreme Court is available to the assessee or the Department only in respect of judgments of the High Court delivered on a reference made to it. There is no right of appeal from an order of a High Court directing or refusing to direct the Tribunal to state a case and refer it to the High Court or an order of the High Court calling for a supplementary statement of the case. The assessee or the Commissioner is also entitled to seek special leave of the Supreme Court to appeal direct from the order of the Tribunal disposing of the appeal in certain circumstances. In an appeal direct from the Tribunal's appellate order the Supreme Court is concerned with the correctness of the Tribunal's order and is empowered to confirm, reverse or vary it in any manner as it thinks fit. But in the case of an appeal of this type the Supreme Court is not entitled to the Tribunal to refer questions of law and state the case to the High Court.

The provisions of the Code of Civil Procedure, 1908 in regard to appeals shall apply in the case of all appeals to the Supreme Court in the same manner as in the case of all appeals from decrees of a High Court. The cost of appeal shall be decided at the discretion of the Supreme Court. Where the judgment of a High Court is varied in the appeal, effect should be given to the order of the Supreme Court in the same manner as provided in the case of a judgment of the High Court.

The assessee is bound to pay the tax due from him in accordance with the assessment made on him irrespective of the fact that a reference to the High Court or an appeal to the Supreme Court has been made by him (Section 265). The High Court may, on a petition made to it for the execution of the order to the Supreme Court in respect of any costs awarded, thereby transmit the order for execution to any Court subordinate to it (Section 266). The Income-tax authorities concerned, including the Tribunal and the Appellate Assistant Commissioner must pass such consequential orders as may be necessary to give effect to the decision of the High Court or the Supreme Court (Section 267)

(E) **Revision by the Commissioner** (Sections 263 and 264) :

The High Court or the Supreme Court can give its judgment only on the questions of law that have been referred to it by the Tribunal, and the Tribunal can decide only such questions as are disputed against the order of the Appellate Assistant Commissioner.

Revision of Orders prejudicial to the Revenue (Section 263) : The Commissioner on his own motion, may call for and examine the record of any proceeding under the Act and if he considers that any order passed by the I.T.O. is erroneous insofar as it is prejudicial to the interest of the Revenue, he may, after giving the assessee a reasonable opportunity of being heard and after making or causing to be made such enquiries as may be necessary, pass such order's as the circumstances of the case justify. This power of revision by the Commissioner includes also the power to enhance or modify the assessment or to cancel the assessment. The Commisioner, however, has no power to revise an order of reassessment made under Section 147 to bring to charge and escaped or concealed income or to pass an order after the expiry of two years from the date of the order sought to be revised. However, this power can be exercised by the Commissioner at any time in the case of any order which has been passed in consequence

of, or give effect to, any finding or direction contained in an order of the Tribunal, the High Court or the Supreme Court. In computing the two-year period of limitation the time taken for giving the assessee a reasonable opportunity of being reheard and any period during which any revision proceeding is stayed by an order or injunction of the Court shall be excluded.

Revision of other Orders (Section 264): In the case of any other order (not being an order prejudicial to the Revenue) passed by any subordinate authority including the Appellate Assistant Commissioner, the Commissioner, may either on his own motion or on receipt of an application from the assessee, call for the record of any proceedings under the Act in the course of whi the order was passed. After making such enquiries as may be necessary the Commissioner may pass such order he thinks fit. The Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the order sought to be revised. If the application for revision is made by the assessee, it must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise comes to know of it, whichever is later. However, the Commissioner may admit an application even after the expiry of one year, if he is satisfied thai the assessee was prevented by sufficient cause from making the application within that period. The application to the Commissioner for revision must be accompanied by a fee of Rs. 25. If an order is passed by the Commissioner declining to interfere in any proceeding, it shall not be deemed to be an order prejudicial to the assessee. However, the Commissioner is not empowered to revise any order in the following cases, *viz.*

(*i*) where an appeal against the order lies to the A.A C. or the Commissioner (Appeals) or the Tribunal but has not been made and the time within which the appeal may be made has not expired or in the case of an appeal to the Tribunal the assessee has not waived his right of appeal ; or

(*ii*) where the order has not been made the subject matter of appeal to the Commissioner (Appeals) or Appellate Tribunal.

3. PENALTIES IMPOSABLE UNDER THE ACT: (Section 270 to 275A):

The Income-tax Act provides for the imposition of a penalty on assessees who wilfully commit any offence under the provisions of the Act. Penalty is levied over and above the amount of any tax or interest payable by the assessee and thus, penalty is distinct and different from the tax payable. Penalty proceedings, however, are a part of the assessment proceedings. The power to impose penalty is given to the I.T.O. and the A.A.C. If the penalty is for concealment and the assessed income exceeds Rs. 25,000, the I.T.O. must refer the case to the Inspecting Assistant Commissioner who is empowered to levy the penalty. The authority concerned is entitled to levy penalty only if he is satisfied in course of any proceedings under the Act that a person has been found guilty of any default in complying with the provisions of the Act. Thus the A.A.C. may impose a penalty on the assessee in an appeal by the assessee himself. Even in cases where the assessee had filed an appeal against an order or penalty imposed by the I.T.O. the A.A.C. can also impose a fresh penalty while allowing the appeal. If the

order of the penalty is set aside in appeal on the ground that the assessee was not given a reasonable opportunity of being heard, the I.T.O. would be entitled to levy a penalty again after rectifying the mistakes in proceedings. The penalty to be levied on an assessee is to be based upon the law as it stood at the time the default was committed and not the law as it stands in the financial year for which the assessment is made.

The various Sections prescribe the minimum and the maximum penalty that can be levied in certain cases though the Commissioner is empowered to waive or reduce the penalty in some cases. The authority concerned has been given the discretion to levy or not to levy a penalty. But if a penalty is levied it cannot be less than the prescribed minimum nor can it exceed the maximum amount prescribed by the Act. The quantum of penalty levied by a lower authority can be modified by a higher authority on appeal, reference or revision. The various defaults in respect of which penalty can be levied under the Act or discussed in the following paragraphs.

(a) **Failure to furnish information regarding Securities etc.** (Section 270) : Under Section 94(6), the Income-tax Officer is empowered to call upon any person to furnish particulars of all the securities in which he had beneficial interest during a particular period. If he fails to comply with such a direction from the Income-tax Officer, it would make him liable to a penalty not exceeding Rs. 500. A persistent failure would make him liable to pay a further penalty of a like amount for every day during which the default continues.

(b) **Failure to furnish Returns, Concealment of Income etc.** (Section 271) : The provisions of Section 271 (1) levying a penalty for certain major defaults, could be summarised as follows :—

Section	*Nature of Default*	*Minimum Penalty*	*Maximum Penalty*
271 (1) (a)	Failure to file return of income without raesonable cause in terms of Section 139 (2) or 148	2% of tax assessed for every completed month of default.	—
271 (1) (a)	Failure to file return, without reasonable cause, within the time allowed under Section 139 (1)	2% of tax assessed for each completed month after the expiry of time allowed by the Income-tax officer	—
271 (1) (a)	Failure to file return of income under Section 139 (4A) in the case of trusts coming within the scope of Sections 11-13	1% of total income (computed without applying Sections 11 and 12) for each year of default and part thereof during which the default continues	

271 (1) (b)	Failure to comply without reasonable cause, with a notice under Section 142 (1) or 143 (2) or failure to comply with direction under Section 142 (2A)	10% of difference between the tax on assessed income and the returned income	50% of such difference
271 (1) (c)	Concealment of the particulars of income or furnishing accurate particulars of income	In respect of return filed on or after April 1, '76, 100% of the amount of tax sought to be evaded	200% of the amount of tax sought to be evaded

For the purposes of Section 271 (1) (i) the description 'assessed tax' means tax as reduced by tax deducted at source and advance tax. The tax paid on self-assessment under Section 140 A is not deductible for the purpose of Section 271(1)(i). While determining the amount of penalty the law to be applied would be the law operative on the date when the default is committed. In the case of late filing of return, the default is said to be committed on the date when the return is to be filed and in the case of non-compliance of notice, default is taken to be committed on the day when the date given in the notice or expires. In the case of concealment of income or furnishing or inaccurate particulars, the date of default is the date on which the return is filed and not the date on which income is earned.

As the expression 'month' is not defined in the Act one has to go by the definition given in Section 3(35) of the General Clauses Act and the 'month' should be the English Calendar month. Accordingly, where there is a little delay in filing return of income and the period of delay is more than one month but less than 2 months penalty cannot be levied under Section 271 (1) (a) on the basis of the period of default of 2 months. These principles emerge from various relevant judicial rulings.

In cases where an assessee attracts liability to penalty under Section 271(1) (c) on account of concealment of his income and the amount so concealed as per the assessment made by the Income-tax Officer exceeds Rs. 25,000/- for the relevant assessment year, the Income-tax Officer should obtain the previous approval of the Inspecting Assistant Commissioner before issuing any direction to the assessee' for payment of penalty. If, however, the amount of income concealed is less than Rs. 25,000/-the Income tax Officer is himself empowered to pass the order for levying penalty without seeking any approval of the higher authorities.

There are 4 Explanations to Section 271(1) which extend the scope of the provisions relating to levy of penalty. For the purpose of levy of penalty for concealment of income the assessee would be deemed to have concealed the particulars of his income or to have furnished false or inaccurate particulars thereof in

cases where, in respect of any facts material to the computation of the taxable income of the assessee :—

(i) he has failed to offer a satisfactory explanation or the explanation offered by him is found by the Income-tax Officer or the Appellate. Assistant Commissioner to be false ; or

(ii) the assessee offers an explanation which he is not able to substantiate ;

(iii) the amount added or disallowed in the computation of the taxable income as a result of the unsatisfactory or false statement of the assessee would be deemed to represent concealed income in respect of which false particulars had been furnished by the assessee.

However, in a case where the assessee has offered an explanation but is not able to substantiate the same in respect of any amount added or disallowed as a result of the rejection of and such explanation by the tax authorities, the assessee would not be deemed to have been guilty of furnishing false particulars of his income if the explanation given by him is *bona fide* and all the facts relating to the same and which are material to the computation of his total income have been properly disclosed by him for purposes of assessment [Explanation 1 to Section 271 (1)].

In cases where the source of any receipt, deposit or outgoing or investment in any assessment year is claimed by any assessee to be an amount which had been added in computing his taxable income or deducted in computing the assessable loss in his assessment for any earlier assessment year/years, but in respect of which no penalty under Section 271 (1) (c)(iii) had been levied, then, that part of the amount which had been so added or deducted in the earlier assessment year immediately preceding the year in which the receipt, deposit, outgoing or investment appears, which is sufficient to cover the amount represented by such receipts, or outgoings or the value of such investments (otherwise known as the utilised amount or value) must be treated as the income of the assessee the particulars of which had been concealed or inaccurate particulars whereof had been furnished for the first preceding year. Where the amount so added or deducted in the first preceding year is not sufficient to cover the utilised amount then, that part of the so added or deducted in the year immediately preceding the first preceding year which is sufficient to cover such part of the utilised amount as is not so covered must be treated as the income of the assessee which had been concealed for the year immediately preceding the first preceding year, and so on, until the entire utilised amount is covered by the amount so added to the income or deducted from the loss of such earlier assessment year or years [Explanation 2 to Section 271 (1)].

According Explanation 3 to failure to file the return of income within the time limits prescribed under Section 153 (1) (a) (iii) would also be treated as a case of concealment of income attracting penalty under the new provisions. Accordingly in cases where any person who has not previously been assessed to tax under the Income-tax Act fails without reasonable cause to furnish his return

of income (within the time limit specified above) under Section 153. in accordance with the requirements of Section 139 in respect of the assessment year commencing on or after Ist April, 1974 and until the expiry of the specified period, no notice had also been served on him under Section 139(2) or Section 148 for the purpose of submission of the return of income, then, if the Income-tax Officer or the Appellate Assistant Commissioner is satisfied that in respect of such assessmnet year/years such person has a taxable income, he must be deemed to have concealed the particulars of his income in respect of such assessment year. The presumption in regard to concealment would be operative even if the assessee furnishes a return of his income after the expiry of the aforesaid period in pursuance of a notice issued by the Income-tax Officer under Section 148 for making an assessment on the assessee in respect of the income that has escaped asessment.

Explanation 4 to Section 271 (1) seeks to define the meaning and scope of the expression "the amount of tax sought to be evaded" which is the basis for levying penalty for concealment of income. Accordingly, the meaning of the expression will have to be taken as follows :

1. In cases where the amount of income, in respect of which particulars have been concealed or inaccurate particulars have been furnished exceeds the total income assessed by the tax authorities—the amount of tax sought to be evaded by the assessee would mean the tax that would have been chargeable on the income in respect of which particulars had been concealed or inaccurate particulars had been furnished had such income been taken to be the total income of the assessee for relevant assesssment year.

2. In cases where the provisions of Explanation 3 apply—the amount of tax sought to be evaded by the assessee would mean the tax on the total income assessed by the Income-tax Officer.

3. In any other case, the amount of tax sought to be evaded must be taken to mean the amount of difference between the tax on the total income actually assessed and the tax that would have been chargeable had such total income been reduced by the amount of income in respect of which particulars had been concealed or false particulars had been furnished.

Wherever penalty is leviable on a tax payer for concealment of income under Explanation 2. the proceedings for imposition of penalty may be initiated by the Income-tax Officer notwithstanding the fact that any proceedings under the Income-tax Act, in the course of which such penalty proceedings could have been initiated, had already been completed. In other words, it is not essential for the Income-tax Officer to ensure that the proceedings in the course of which penalty proceedings had been initiated are also continued simultaneonsly with the proceedings for the imposition of penalty in cases covered by the Explanation where unexplained or undisclosed investment, outgoings, receipts or monies would be treated as the concealed income of the assessee.

Where the levy of penalty falls within the scope of Explanation 3, that is, on account of the assessee's failure to file the return of his income within the time-limits specified, the maximum penalty that would be levied on the assessee should

not exceed, in the aggregate, the amount of tax sought to be evaded. However, where penalty is already leviable under sub-clause (a) of sub-section (1) of Section 271 for the delayed filing of return of income, no penalty would be levied again on the assessee under the new provisions as if it is a failure to file the return of income amounting to concealment of income attracting liability to penalty.

Penalty not to be levied [Section 271 (3)] : (a) No penalty for failure to return the correct total income under Section 159 (1) can be levied on an assessee if his total income does not exceed the maximum amount not chargeable to tax in his case by Rs. 1,500.

(b) Where a person has failed to comply with a notice under any of the Sections 139 (2) and 148 and proves that he has no income liable to tax, the penalty imposable on such a person shall not exceeed Rs. 25.

(c) No penalty shall be imposed on a representative assessee being the agent of a non-resident in respect of the non-resident's income which is deemed to accrue or arise to him in India under Section 9(1) for failure to furnish a voluntary return Section 139(1).

Penalty in the case of Firm : In all the above cases where the person liable to pay penalty in a registered firm or an unregistered firm which is assessed as registered under Section 183 (b) then, the penalty imposable on the firm shall be the same amount as would be imposable on that firm it were unregistered.

Distribution of profits by the Partners which does not accord with the Partnership Deed [Section 271 (4)] : If, during the course of any of the income-tax proceedings, it is discovered by the I.T.O. or the A.A.C. that the profits of a registered firm have been distributed otherwise than in accordance with the share of the particulars, as shown in the instrument of partnership and in consequence a partner has returned his income below the real amount, he may direct such a partner to pay, in addition to the tax, if any, payable by him, by way of penalty a sum not exceeding one and a half times the amount of tax which has been avoided or would have been avoided if the income returned by such partner had been accepted as his correct income. But no refund or other adjustment shall be allowed to any other partner by reason of such direction.

Failure to keep and maintain or retain Books of Accounts, Documents etc : Section 271A seeks to impose penalty on tax payers for the failure to keep, maintain or retain the books of accounts and other documents which are prescribed by the Central Board of Direct Taxes under Section 44AA in the manner specified by the rules laid down by the Board. Wherever there is a failure on the part of the assessee to comply with the requirements prescribed by the Board in this regard without reasonable cause in respect of any previous year, the Income-tax Officer, the Appellate Assistant Commissioner and the Commissioner (Appeals) are empowered to direct that the assessee shall be liable to pay by way of penalty, a sum which shall be not less than 10% but not more than 50% of the amount of tax, if any, which would have been avoided if the income returned by the assessee had been accepted as the correct income. The imposition of penalty for failure to comply with the requirements relating to maintenance and retention of books of acounts and other documents would be over and above the penalty that would be levied on the assessee for concealment of income or for furnishing false particulars of income as discussed earlier.

Failure to get accounts audited as required by Section 44AA : The Finance Act, 1984 has inserted a new section 271B with effect from 85-86 assess-

ment year. This section provides that if any person file, without reasonable cause, to get his accounts audited in respect of any previous year or years relevant to an assessment year or obtain a report of such audit as required by section 44AB, the Income-tax officer may direct that such person shall pay, by way of penalty.

(a) a sum equal to ½% of the total sales, turnover or gross receipts in business or gross receipts in profession in such previous year or years or

(b) Rs. 1,00,000 whichever is less.

Penalty for Failure to answer questions sign statements and allow inspection, etc. : Section 272A seeks to impose penalty on tax payers for their failure to answer questions which have been asked to them by the tax authorities and to sign the necessary statements or allow inspection of certain documents etc. Accordingly, in cases where a person—(i) who is legally bound to state the truth of any matter touching the subject of his assessment, refuses to answer any question demanded of him by an Income-tax Officer or an Appellate Assistant Commissioner or the Inspecting Assistant Commissioner or even the Commissioner of Income-tax in the exercise of his powers under the Income-tax Act ; or (ii) who refuses to sign any statement made by him in the course of any proceedings under the Income-tax Act which an Income-tax Officer or an Appellate Assistant Commissioner or an Inspecting Assistant Commissioner or Commissioner (Appeals) or even the Commissioner may require him to sign, would be liable to pay, by way of penalty, a sum which may extend to Rs. 1,000. This sum of Rs. 1,000 is only the maximum limit of the amount of penalty and minimum amount in such cases of failure on the part of the assessee would be at the discretion of the Income-tax Authority who would impose the penalty.

In cases where any person, without reasonable cause or excuse, fails to comply with the following requirements, he would be liable to pay, by way of penalty a sum which may extend to Rs. 10 for every day during which the default or failure continues :

(i) To furnish in due time any of the return or statements specified in Sections 138, 206, 285 B and or 286 ;

(ii) To allow inspection of any registers or records under Section 134 or of any entry in such register or to allow copies of such registers or of any entry thereon to be taken for purpose of investigation ;

(iii) To furnish a certificate as required under Section 206 in respect of tax deducted at source ;

(iv) To deduct and pay the tax as required under Section 226(2).

In all the above four cases, the maximum penalty that could be levied depend upon the length of time for which the default continues and would in all cases be calculated at the rate of Rs. 10 for every day of default without any monetary ceiling. The minimum amount of penalty in all such cases is, however, left to the discretion of the tax authority who is to impose the penalty.

The items of penalties referred to in the above two paragraphs could be imposed by the Commissioner of Income-tax or the Appellate Assistant Commissioner in cases where the contravention or failure or default in respect of which the penalty is impossable comes in the course of any proceedings before the Commissioner or the Appellate Assistant Commissioner, as the case may be. In all other cases, the penalty could be levied only by the Inspecting Assistant

Commissioner. In all the above cases before levying any penalty or passing any order to this effect, the person on whom the penalty is sought to be imposed must be given a reasonable opportunity of being heard in the matter.

Penalty for Failure to Comply with the Provisions of Section 139A relating to Permanent Account Numbers : Section 272B provides that, if any person without reason, without cause, fails to comply with the provisions of Section 139A, he would be liable to pay by way of penalty a sum which may extend to Rs. 500. The order for imposing penalty in such cases could be passed by the Income-tax Officer himself. However, before imposing the penalty the person on whom it is sought to be levied must be given a reasonable opportunity of being heard in the matter.

Penalty on Charitable Trusts for failure to file the return of Income : In every case, where the trustees of charitable trust or institution who are required to file the return of income of the trust under Section 139 (4A), before taking into account the amount of income exempt from tax under Sections 11 and 12, fail to file return of income within the time specified under that Section, they would attract liability to penalty under clause (a) of sub-section (1) of Section 271. The amount of penalty that could be levied in such cases shall not however exceed *one per cent of the total income* of the trust for each part thereof computed before giving effect to the provisions of Section 11 and 12 for granting exemption to the charitable trust or institution.

(c) Failure to give Notice of Discontinuance (Section 272) : An assessee whose business or profession is discontinued is obliged under Section 176 (3) to give a notice of such a discontinuance to the Income-tax Officer within 15 days of the business or profession having been discontinued. Failure to comply with this requirement shall entail a penalty which may be not less than 10% but not more than 100% of the amount of tax which may be assessed on him in respeet of the income from business or profession upto the date of its discontinuance.

(d) Submission of a False Estimate or Failure to pay Advance Tax (Section 273) :

The provisions of Section 273 are summarised below :

Section	Nature of Default	Minimum Penalty	Maxi. Penalty
1	2	3	4
273(1) (a)	Furnishing under Section 209A (1) (a) statement of advance tax which the assessee knew or had reason to believe to be untrue (See Note 1 and 2)	10% of : a. 75% of assessed tax *minus* advance tax paid during the financial year *or* b. tax payable on the basis of latest assessment order or latest self-assessment (whichever is greater *minus* advance tax paid during the previous, year whichever is less	15% of the amount mentioned in column 3.

Section	Nature of Default	Minimum Penalty	Maxi. Penalty
1	2	3	4
273(1) (b)	Failure, without reasonable cause, to furnish a statement of advance tax under Section 209A (1)(a) (See Note 2)	*10% of 75% of the assessed tax*	*150% of the assessed tax.*
273(2) (a)	Furnishing untrue estimate of advance tax under Section 212 (1), (2) or under Section 209A (1), (2), (3) and (5) (See Note 2)	10% of: a. 75% of assessed tax *minus* advance tax paid during the previous year, or b. advance tax payable under Section 209A (1) (a) or 210 *minus* advance tax actually paid, whichever is less	150% of the amount mentioned in Column 3.
273(2) (aa)	Failure to submit true estimate of advance tax under Section 212 (3A) or (w.e.f. June 1, 19 8) under Section 209A(4) (See Note 2)	10% of (75% of assessed tax *minus* advance tax paid) 10% of (75% of assessed tax *minus* advance tax paid)	150% of the amount mentioned in Column 3 150% of 75% of assessed tax
273(2) (b)	Failure to submit an estimate of advance tax under Section 212(3) or (w.e.f. June 1, 78) under Section 209 A (1) (b) (See Note 2)	10% of advance tax payable under Section 209A (1) (a) or 209A (1) (b) or 209A (2) or 210, which falls short of 75% of assessed tax	150% of the amount mentioned in Column 3.
273(2) (c)	Failure to submit a higher estimate of advance tax under Section 212 (3A) or Section 209A (4)		

Notes: 1. The expression 'assessed tax' for the purpose of Section 273 means the tax determined on the basis of regular assessment (as reduced by the amount of tax deducted at source under Sections 192 to 194, 194C and 194D) so far as such tax relates to the income subject to advance tax and so far as it is not due to variations in the relates of tax to be made by the Finance Act enacted for the year in which the regular assessment is made tax paid on self assessment is not deductible.

2. For the purpose of Section 273 where the defaults under Section 273 are committed by a company, for the purposes of levying penalty, the shortfall will be

reckoned with reference to 83⅓% (instead of 75%) of the assessed tax, with effect from September 1, 1980.

(e) **Penalty for Non-payment of Taxes** (Section 221) : Penalty is also to be levied when an assessee is in default or is deemed to be in default in making payment of the tax demanded from him. In such a case, in addition to the amount of arrears and the amount of interest payable under Section 220(2), he is liable to pay, by way of penalty, an amount which can be increased from time to time in the event of the default being continued. However, in no case, the penalty can exceed the amount of tax in arrears. It may be noted that the minimum limit for the levy of penalty has not been prescribed in this case. But in any case no penalty shall be levied unless the assessee has been given a reasonable opportunity of being heard. Penalty and interest could be levied even for non-payment of advance tax.' The assessee would continue to be liable to penalty even in cases where, before the levy of penalty, the tax due from the assessee had been paid.

Under Section 220 (2), if the tax demanded (including advance tax) is not paid before it is overdue, simple interest thereon at 12% is payable from the day commencing after the expiry of 35 days of the service of the notice of demand for payment of tax. The interest is not in the nature of a penalty referred to in the foregoing paragraphs, but is an additional charge imposed for withholding payment of Government's dues. If an application is made by the assessee before the expiry of the due date for payment specified in the notice of demand, the Income-tax Officer may extend the time for payment or allow payment by instalments subject to such conditions as he may think fit to impose in the circumstances of the case. If the amount is not paid within the time prescribed in the notice of demand or the time subsequently extended by the Income-tax Officer, as the case may be, the assessee shall be deemed to be in default. In a case where the payment by instalment has been allowed and the assessee commits a default in paying any one of the instalments within the time fixed, the assessee shall be deemed to be in default for the whole amount then outstanding (Section 220).

(f) **Procedure for assessment of Penalties** (Section 274) : In all cases before a penalty is imposed, the assessee should be given a reasonable opportunity of being heard. When a penalty is imposed by the Appellate Assistant Commissioner or a Commissioner (Appeals) he should send a copy of his order the Income-tax Officer concerned.

(g) **Reduction or Waiver of Penalties and Interest** : Section 273-A authorises the Commissioner of Income-tax to reduce or waive the amount of penalty or interest payable by an assessee. The exercise of this power by the Commissioner, is purely at his discretion and may be done either on his own motion or otherwise, that is on receipt of an application from the assessee. Under these provisions the Commissioner's powers to reduce or waive penalty or interest could be exercised in the following circumstances.

1. Any penalty which has been imposed or is imposable on any assessee under Section 271 (i) for his failure, without reasonable cause to furnish his return of income under Section 139 (1).

2. Any penalty which has been imposed or is imposable on an assessee for concealment of his income or for furnishing false or in accurate particulars thereof under Section 271 (1) (c) (iii).

3. The interest payable by an assessee under Section 139 (8) for delay in filing the return of income and/or, under Sections 215 and 217 for the failure or shortfall in the payment of advance tax.

4. Any penalty that has been imposed or imposable under Section 273 for the failure to pay or for the shortfall in making the payment of advance tax during the financial year.

The Commissioner would be entitled to reduce or waive the interest or penalty payable by any person *only* if the following conditions ar satisfied.

1. In cases of penalty for failure to file a return of income under Section 139 (1), the reduction or waiver of penalty would be permissible only if the assessee has, prior to the issue of a notice by the Income-tax Officer under Section 139(2), filed a return of his income voluntarily and in good faith making a full and true disclosure of his income, profits or gains chargeable to the tax under the Act.

2. In cases where penalty is levied or leviable on an assessee for concealment of income, the reduction or waiver by the Commissioner would be permissible only, if, prior to the detection of the concealment by the Income-tax Officer, the assessee has made a full and true disclosure of all the particulars in respect of his income and, that, too, voluntarily and in good faith.

3. In cases of interest, for delay in filing the return of income or for shortfall or failure to pay advance tax, the reduction or waiver by the Commissioner would be permissible only if, prior to the issue of a notice by the Income-tax Officer under Section 139 (2), the assessee had made a full and true disclosure of his income and has paid the tax due on the income so disclosed voluntarily and in good faith. In cases where no notice under Section 139(2) had been issued by the Income-tax Officer and the period for the issue of such a notice has expired, the assessee should have made a full and true disclosure of his income prior to the issue of a notice to him by the Income-tax Officer under Section 148 for the purposes of re-opening an assessment to bring to tax any income that had escaped assessment. Only if these conditions are fulfilled the Commissioner would exercise his power and waive or reduce the amount of penalty of interest that has been or may be levied on the assessee.

4. Further, it is essential that in all the above there cases the assessee must have co-operated with the department in any enquiry relating to the assessment of his income and he must also have either paid or made satisfactory arrangements for the payment of any tax or interest, which may become payable in consequence of any order passed by the I.T.O. or the Commissioner under the Income-tax Act in respect of the assessment year.

For purposes of waiver of the penalty, a person must be deemed to have made a full and true disclosure of his income or of all the particulars relating thereto in any case where the excess of income assessed over the income returned is of such a nature at not to attract the imposition of

any penalty under Section 271 (1)(c). In other words in every case where there is the scope for levying penalty on an assessee for having concealed his income liable to tax or for having furnished false or inaccurate particulars of such income, the assessee would not be deemed to have made a full and true disclosure of his income.

However the Commissioner of Income tax would be entitled to exercise his power only after getting the previous approval of the Central Board of Direct Taxes in the following cases:

1. Where the penalty imposed or imposable for delay in filing a return or the minimum penalty imposable under Section 273 for failure to pay or for a shortfall in making payment of advance tax exceeds of Rs. 50,000 for the relevant year;

   However, in cases where the disclosure of concealed income by the assessee or other particulars relating to the assessments relates to more assessment years than one, then, the aggregate amount of penalty imposed or imposable in both the cases in respect of all the years should exceed Rs. 50,(00 in order that the Commissioner is required to obtain the prior permission of the Board.

2. Where penalty is imposed or imposable for concealment of income for any assessment year, the aggregate amount of such income concealed exceeds Rs. 5,00,000; however where the concealment relates to more assessment years than one, the limit of Rs. 5,00,000 will have to be applied with reference to all the assessment years in respect of which the concealment had taken place. In other words unless the aggregate amount of concealed income exceeds Rs. 5,00,000, it is necessary for the Commissioner to obtain the prior permission of the Board. The Commissioner is entitled, wherever permissible, to pass the order for the reduction or waiver of penalty or interest after consideration of all the relevant materials for the purpose.

   In cases where an order for reduction or waiver of penalty has once been made in favour of any person, whether such an order relates to one or more assessment years, the assessee shall not be entitled to any relief of any time subsequent thereto in relation to any other assessment year or years. In other words, when once an assessee has been granted relief by way of reduction or waiver of penalty or interest he would not be entitled to any such relief once again throughout his life for the purpose of income-tax assessments.

While exercising the powers of reduction or waiver of penalty the Commissinar is required to pass an order in writing and also to record his reasons for so doing. These powers could be exercised by the Commissioner either on his own motion or on receipt of an application from the assessee or from anyone else, he is also entitled to stay or compound any proceedings for the recovery of any penalty or interest which might have been levied on the assessee in cases where he is satisfied that

(i) to do otherwise would cause genuine hardship to the assessee having due regard to all the facts and circumstances of the case ; and

(ii) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for the recovery of any amount due from him.

The Commissioner's order for reduction or waiver of penalty or interest is final and cannot be challenged in any court or before any authority.

(h) **Time-limit for Imposition of Penalty** (Section ..5) : The time-limit for making an order imposing a penalty would be ordinarily two years from the end of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed. However where the relevant assessment or other order is the subject-matter of an appeal to A.C.C. or the Commissioner of Appeals or an appeal by the I.T.O. to the Tribunal, the time-limit for completion of the penalty proceedings will be either the period as stated above or six months from the end of the month in which the order of the A.A.C. or the Commissioner (Appeals) the Tribunal as the case may, is received by the Commissioner which ever is *later*. But in computing this period of limitation the time taken to give the assessee a reasonable opportunity of being heard or reheard under Section 129 and any period during which the proceedings for the levy of the penalty are stayed by an order or injunction of the Court or any period during which the immunity granted under Section 245H remained in force must be excluded.

4. OFFENCES AND PROSECUTIONS (Sections 275-A to 280)

As distinguished from the penalties which may be imposed by the Income-tax authorities under Sections 270 to 275, the, imposition of a fine or the launching of a prosecution for any offence under the Act can be made only by the Magistrate of a Court under Sections 275A to 280. In respect of the same default of an assessee a penalty may be imposed as well as a prosecution may be launched against him in all cases except those specified in Section 279 (1A). But in certain cases even the income-tax authorities have been empowered to impose a fine on the assessee in addition to the penalty. For instance, Section 131 (2) authorises the authority concerned to impose a fine on any person who intentionally fails to attend or produce the books of account or documents at the place and time as required by the notice issued for the purpose. The fine in this case would be of such an amount as the authority may think fit but not exceeding Rs. 250. The provisions in the Act in regard to the various offences and prosecutions for such offences are discussed in the following paragraphs.

1. **Contravention of an Order under Section 132 (3)** (Section 275-A): In respect of any proceedings taken by an Income-tax authority in exercise of the powers of search and seizure, Section 132 (3) empowers the authority concerned to serve an order on the owner or the person who is in immediate possession or control of any books of account' or other documents, money, bullion, jewellery or other valuable articles or things, that he shall not remove, part with or otherwise deal with it except with his prior permission. For the purpose of ensuring compliance with the order the officer concerned may take such steps as may be necessary. Any person who contravenes the order of the Income-tax authority served on him under Section 132 (3) shall be punishable with rigorous imprisonment which may extend to two years and shall also be liable to fine.

2. **Failure to comply with the Requirements of Section 178 (1) & (3)** (Section 276A) : Any person who is appointed as the liqutdator of a company and and (i) fails to give notice of his appointment to the I.T.O. as required by Section 178 (1), or (ii) fails to set aside the amount which is intimated to him by the I.T.O. as being sufficient to recover the tax liabilities of the company, or (iii) parts with any of assets of the company or the properties in his hands in contravention of the provisions of Section 178 (3) shall be punishable with rigorous imprisonment. The term of such imprisonment would be a minimum of six months and a maximum to two years.

3. **Failure to comply with the Requirements of Section 269AB**

Whoever, without reasonable cause or excuse fails to comply with the provisions of Section 269AB (registration of certain specified transactions) or directions of the competent authority issued under sub-section 5 of Section 269 (I) shall be punishable with rigorous imprisonment for a term which my extend to two years and shall also be liable to fine. Such imprisonment shall not be for less than six months in the absence of special and adequate reasons to the contrary to be recorded in the judgement of the Court.

4. **Failure to deduct and pay Tax** (Section 276B) : Section 276A provides for a rigorous punishment to persons who are liable for failure to deduct tax at source or, pay the tax to the Central Government. Accordingly, if a person fails to deduct or, having after deducted, fails to pay the tax as required by or under Section 80E (9) or chapter XVII B he shall be punishable :—

(a) in a case where the amount of tax he has failed to deduct or pay exceeds Rs. 1 lakh, with rigorous imprisonment for a minimum period of six months upto a maximum of seven years and also with a fine ;

(b) in any other case, with rigorous imprisonment for a minimum period of three months upto a maximum of three years and also with a fine.

5. **Wilful Attempt to evade Tax etc** : Section 276-CC provides for rigorous punishment for persons who are punishable-for failure to furnish their returns of income. Under the provisions of Section 276 C, cases of wilful attempt to evade tax, etc , would attract liability for prosecution and fine. The effect of the new provision is that if any person wilfully attempts in any manner whatsoever to evade any tax, penalty or interest which is chargeable or imposable under the Income-tax Act he shall be punishable notwithstanding the fact that a penalty has already been imposed or may be imposable on him in respect of the default or failure. For this purppse, a wilfull attempt to evade any tax penalty or interest chargeable under the Income-tax Act or the payment thereof must be taken to include a case where any person—

(a) has in his possession or control any books of accounts or other documents being books of accounts or other documents relevant to any proceeding under the Income-tax Act, containing a false entry or statement ; or

(b) makes or causes to be made any *false entry or statement in such books* of accounts or other documents ; or

(c) wilfully omits or causes to be omitted any *relevant entry or statement* in such books of accounts and other documents ; or

(d) causes any other circumstance to exist which will have the effect of *enabling such person to evade any tax,* penalty or interest chargeable or imposable under the Act of the payment therr

The punishment would be as follow :

(i) In a case where the amount of tax, fine, interest or penalty sought to be evaded exceed Rs. 1 lakh—with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and also with fine :

(ii) In any other case— with rigorous imprisonment for a term which shall not be less than three months which may extend to three years and also with fine.

If a person wilfully admits in any manner whatsoever to evade the payment of any tax, penalty or interest under the Income-tax Act, he would also be made liable for punishment with rigorous imprisonment for a term which shall not be less than three months but which may extend to three years and shall, at the discretion of the Court, be also liable to fine. This punishment would be over and above the penalty that may be imposable on him under other provisions of the Act.

6. **Failure to furnish Returns of Income** (Section 276CC) : If a person wilfully fails to furnish in due time the return of income which he is required under Section 139 (1) or (2) or 148, he shall be punishable with rigorous imprisonment for a term which may extend to one year or with fine equal to all amount calculated at the rate of not less than Rs. 4 and not exceeding Rs. 10 for every day during which the default continues or with both.

With effect from 1-10-1975 the punishment would be as under :

(i) in a case where amount of tax. which have been evaded if the failure had been dicovered, exceeds Rs. 1,00,000—with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine ;

(ii) in any other case with imprisonment for a term which shall not be less than three months but which may extend to three years and with fine.

However, a person shall not be proceeded against under Section 276CC for failure to furnish in due time the return of income voluntarily under Section 139 (1) (a) of—

(i) the return is furnished by him before the expiry of the relevant assessment year ; or

(ii) the tax payable by him on the total income determined on regular assessment as reduced by the advance tax, if any paid and/or any tax deducted at source not does exceed Rs. 3,000

7. **Failure to produce Accounts and Documents** (Section 276 D) : If a person wilfully fails to produce or cause to be produced on or before the date specified in a notice issued under Section 142(1) such accounts and documents as are required under the notice or wilfully fails to comply with any direction issued to him under Section 142(2A) in the matter of tax audit, he shall be punishable with rigorous imprisonment for a term which may extend to one year or shall be liable to fine of a sum to be calculated at a minimum of Rs. 4 and a maximum of Rs. 10 for every day during which the defalt continues or with both.

8. **Failure to comply with the provisions of Sections 269T.** (Section 276E) : If a person, without reasonable cause or excuse, repays any deposit referred to in Section 269T otherwise than in accordance with the provisions of that section, he shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine equal to the amount of such deposit.

9. **False Statement in Declaration** (Section 277) : A person who (i) makes a false statement in any verification made by him under the Act, or any rule made thereunder, or (ii) delivers a false statement or account. knowing or believing them to be false or untrue, will be punishable with under Section 277.

(a) in a case where the amount of tax which would have been evaded if the false statement had been accepted as true exceed Rs. 1 lakh with rigorous imprisonment for a minimum period of six months which may extend to seven years and also with a fine ;

(b) in any other case—with rigorous Imprisonment for a minimum period three months up to a maximum term of three years and also with fine.

10. Under Section 278 where a person abets or induces in any manner another person to make and deliver an account or a statement or declaration relating to any income chargeable to tax which is false and which he either knows to be false or does not believe to be true or to commit an offence under Section 276-C (1), he would be punishable as follows :

(i) In a case where the amount of tax, penalty or interest which would have been evaded, if the declaration, account or statement had been accepted as true or which is wilfully attempted to be evaded exceeds Rs. 1 lakh which rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and also with a fine ;

(ii) In any other case—with rigorous imprisonment for a term which shall not be less than three months but which may extend to three years and with fine. Thus, under the amended provisions, the punishment has become more stringent and the Court does not have the discretion of imposing a fine in lieu of the punishment by way of rigorous imprisonment.

11. **Punishment for second and subsequent Offences :** Section 278-A provides that, if any person convicted of an offence under any of the Sections 276-B, 276-C (1), 276-CC 277 or 278 is again convicted of an offence under any one or more of the aforesaid provisions, he shall be punishable for the second and every subsequent offence with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and also with a fine ;

12. **Offence by companies :** Under the provisio.. of Section 278-B in cases where an offence under the Income tax Act has been committed by a company, every person who, at the time the offence was committed, was in charge of and was responsible to the company for the conduct of the business of the company, as well as the company, must be deemed to be guilty of the offence and would *consequentiy be liable to be proceeded against* and punished *accordingly*. However if the person concerned proves that offence was committed without his knowledge or that he has exercised all due diligence to prevent the commission of any such offence, he would not be made liable for punishment in respect of the offence committed by the company. It has also been specifically provided that in cases where an offence under the Income-tax Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of or is attributable to any negligence on the part of any Director, Manager, Secretary or other Officer of the company, then such Director, Manager, Secretary or other Officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

For this purpose, the term 'company', as used in the Section, must be taken to mean a body corporate and *to include* a firm and also an association of persons or a body of individuals, whether incorporated or not. Accordingly, the partners' of a firm, members of the association and also the officer of the firm or the association would also be liable for punishment in respect of the offence. The term 'Director' must in relation to firm be taken to mean a partner of the firm and in relation to an association of persons or a body of individuals anv member who is controlling the affairs of the association or body as the case may be.

13. **Offences by Hindu Undivided Families :** Section 278-C provides that in case where any offence under the Income-tax Act has been committed by a Hindu undivided family, the karta of the family would be deemed to be guilty of the offence and would become liable to be proceeded against and punished accordingly. However, if the karta proves that the offence was committed without his knowledge or that he has exercised all due diligence to prevent the commission of such an offence, would not be made liable for punishment. It has also baen specially provided that in cases where an offence has been committed by a Hindu undivided family and it is proved that an offence has been committed with the consent or connivance of or is attributable to any negligence on the part of any member of the family, then such member of the family must also be deemed to be guilty of that offence and would, therefore, be liable to be proceded against and punished accordingly.

14. **Presumption in regard to assets, Books of Accounts, etc :** Section 278-D provides in case where, during the course of any search made under Section 132, any money, bullion, jewellery or other valuable articles or things or any

books of accounts or other documents had been found in the possession or control of any person and such assets or books of account or other documents are tendered by the prosecution in evidence against such person and/or against any person who is convicted of an offence under Section 278, the provisons of Section 132(4A) would apply, in relation to all such books of accounts and other documents. Accordingly, it would be presumed that such books of accounts or other documents and assets belong to the person in whose control or possession they were found, at the time of the search and also that the contents of such books of account and other documents are true.

Similarly, in cases where any books of accounts or other documents and assets are taken into custody from the possession or control of any person by the officer or authority specified in Section 132 A (1) (a) or (c) and these are delivered to the requisitioning officer under Section 132A (2), it would be presumed that the presumption similar to the one mentioned earlier would operate in these cases as well. It would be for assessee to rebut the presumption wherever necessary by producing cogent and reliable evidence.

15. **Prosecution to be made at the instance of the Commissioner** (Section 279) : The proceedings to punish a person in the manner, described above, can be initiated only after his prosecution in a court has been secured at the instance of the Commissioner. The Commissioner may compound any offence either before or after initiation of the proceedings. If a person is proceeded against under any of the provisions of Sections 275A to 278C, then a statement made of accounts or documents produced before any authority under the Act shall not be inadmissible as evidence for purposes of the prosecution proceedings merely on the ground that such accounts, documents or statements were produced in the belief that the penalty imposable would be reduced or waived under Section 271(4A) or that the offence would be compound.

16. **Certain Offences to be Non cognizable** : Section 279-A specifically provides that the following offences must be deemed to non cognizable with in the meaning of the provision of the Code of Criminal Procedure, 1973. The offences which would be cognizable are the following :

(i) Failure deduct or pay the tax deducted at source (Section 376-B)

(ii) Wilful attempt to evade tax, penalty or interest (Section 276-C)

(iii) Failure to furnish in time the return of income (Section 275-CC)

(iv) Making false statements, verifications, etc. (Section 277)

(v) Abetment of or inducement to make false returns, accounts statements declarations, etc. (Section 278).

17. **Disclosure of particulars by public servants** (Section 280) : If a public servant furnishes any information or produces any documents in contravention of the provisions of Section 138 (2) he would be liable to be prosecuted, but only with the prior sanction of the Central Government. If the offence is proved he would be punishable with imprisonment which may extend to six months and in addition he would be liable to pay a fine.

5. ACQUISITION OF IMMOVABLE PROPERTIES BY THE GOVERNMENT ; (Sections 269A to 269S)

General : On the basis of the recommendations of the Wanchoo Committee the provisions of the Income-tax Act, Wealth-tax Act and the Gift-tax Act have been amended with the following objects :

(i) to counter evasion of tax through understatement of the value of immovable property in sale deeds and also to check the circulation of black money, by empowering the Central Government to acquire immovable properties including agricultural land, at prices which correspond to those recorded in the sale deeds ;

(ii) to curb the widespread practice of benami holding of property with a view to check tax evasion, by debarring the real owner from enforcing the claim to such property in a court of law unless he has declared the income from that property or the property itself for purposes of income-tax and wealth tax and/or has given notice of his claim to the property to the income-tax authorities ; and

(iii) to improve the present arrangements for valuation for purposes of income-tax, wealth-tax and gift-tax laws of buildings, lands or other assets, by augmenting the set up of the official valuation machinery and enhancing its powers on the one hand by bringing about better regulation and discipline over non-official valuers, on the other.

The provisions relating to the achievement of the first and third objects have been outlined in the following paragraphs while those relating to the second objective have been discussed latter on in this study paper.

Chapter XXA containing Sections 269A to 269S deal with acquisition.

Definitions : Section 269A defines certain important expressions used in this Chapter.

The expression '**apparent consideration**' in relation to any immovable property which is transferred, has been defined to mean the following :

(i) **if the transfer is by way of sale**, the consideration for such transfer as specified in the instrument of transfer ;

(ii) **if the transfer is by way of exchange**—

(a) where the consideration for the transfer consists of a thing or things only, the price that such thing/s would ordinarily fetch on sale in the open market on the date of execution of the transfer deed ;

(b) where the consideration for the transfer consists of a thing or things and a sum of money, the aggregate of the price that such thing/s would ordinarily fetch on sale in the open market on the date of execution of the instrument of transfer and the sum of money.

It also includes any right acquired by a person over building which has already been constructed or is to be constructed through acquiring the membership of a cooperative society, company, association of persons etc.

The expression, **'immovable property'**, means any land or any building or part of a building and includes where any land or building or any part thereof is transferred together with any machinery, plant, furniture, fittings or other things, such machinery, plant, furniture, fittings or other things also. For this purpose, land, building, part of a building, machinery, plant and furniture, fittings and other things include any rights therein.

(iii) **if the transfer is by way of lease**

(a) if the consideration consists only of premium, the amount of premium mentioned in the instrument of transfer.

(b) if the consideration consists of rent only then the aggregate rent and service charges etc. forming part of rent as specified in the instrument of transfer.

(c) if the consideration consists of premium and rent, the aggregate of premium, rent, service charges etc., as specified in the instrument of transfer.

Where the whole or part of consideration for such a transfer is payable in future, apparent consideration will be determined by discounting such consideration @ 8 per cent per annum.

A person can acquire a right in a building which has already been constructed or which is to be constructed by way of becoming a member of a cooperative society or by acquiring shares in a company or other association of persons. The definition of "immovable property" as below covers such a right. When transfer is effected of such immovable property the apparent consideration will be

(i) where only money is payable, such sum of money.

(ii) where the consideration consists of a thing, the price it would fetch in the open market on the date of the transfer.

(iii) where the consideration consists of things and money, the aggregate of such sum plus the value such a thing would fetch in the open market.

With regard to the consideration payable at a future date, present discounted value @ 8% is to be adopted as mentioned above.

The term **'transfer'** in relation to any immovable property means transfer of such property by way of sale or exchange.

Fair market value : In the case of immovable property.

(a) *transferred by way of sale or exchange* : the value of such immovable property would fetch if sold in the open market on the date of execution of the instrument of transfer.

(b) *transferred by way of lease* : (where the consideration is only by way of premium), the value such premium would fetch, in the open market on the date of execution of the instrument of transfer of such property.

(c) being a right acquired by a person through the membership of a cooperative society or a company, the fair market value will be the consideration that such transfer would fetch in the open market on the date of the transfer.

The expression **'person interested'**, in relation to any immovable property includes all person claiming, or entitled to claim, an interest in the compensation payable on account of the acquisition of that property by the Central Government under this Chapter of the Income-tax Act.

The term **'Court'** means a principal civil ꞁrt of original jurisdiction unless the Central Government has, in exercise of the powers conferred on it under Section 269 A (c), appointed a special judicial officer within any specified local limits to perform the functions of the court under this Chapter.

Parties to the

(i) transfer of flats or premises owned through the medium of cooperative societies and companies

(ii) agreements of sale followed by part performance as visualised in section 53A of the Transfer of Property Act, 1982 and

(iii) long-term leases (namely, lease for a period of not less than 12 years) will be required to register with competent authority a statement in the prescribed form giving particulars of such transfer within the prescribed period. Failure to furnish the prescribed statement in time will render the defaulter liable to to punishment with rigorous imprisonment which may extend to two years and also with fine. The other provisions of the Amendment Act are mainly of anciliary of of incidental nature. Thus as a result of the Amendment Act the provisions of chapter XXV would be applicable not only in cases of transfer of immovable property by way of sale or exchange but also other cases of transfers as envisased in the Amendment Act.

Competent Authority (Section 269 B) : The provisions of this Chapter are to be implemented by the 'competent authority' i.e., an Assistant Commissioner of income-tax authorised by the Government to perform the functions assigned under this Chapter. The Central Government has been empowered to authorise, by any general or special notification in the Official Gazette, as many Assistant Commissioners of Income-tax, as it thinks fit, to perform the functions of a competent authority and also to define the local limits within which the competent authority should perform its functions. The other provisions of Section 269B regulate the jurisdiction of the competent authority and also empower the Board to determine the question in case of any dispute.

For the purpose of this section, immovable property being rights acquired through the membership of cooperative societies or companies will be deemed to be situated at the place where the concerned building is constructed or is to be constructed.

Initiation of proceeding for acquisition of immovable properties (Section 269C) : The proceedings for acquisition of immovable property which has been transferred will be initiated by the competent authority in all cases where it has reason to believe that—

(i) the fair market value of the property in question exceeds Rs. 25,000 ; Rs. 1,00,000 with effect from 1.6.84.

(ii) the property has been transferred for an apparent consideration which is less than the fair market value of the property ;

(iii) the consideration for the transfer of the property as agreed to between the parties has not been truly stated in the instrument transfer ; and

(iv) the object of the transfer is either—(a) to facilitate the reduction or evasion of the liability of the transferor to pay tax in respect of any income (whether by way of capital gains or otherwise) arising from the transfer ; or (b) to facilitate the concealment of any income or any moneys or other assets which have not been or which ought to be disclosed by the transferee for purposes of the Income-tax Act, 1961, the Income-tax Act, 1922 or the Wealth-tax Act, 1957.

Before initiating the proceedings to acquire the transferred properties the competent authority must record his reasons for doing so. Further, no proceedings shall be initiated by the competent authority, unless it has reason to believe that the fair market value of the property exceeds the apparent consideration thereof by not less than 15% of the apparent consideration.

In cases where the fair market value of immovable property exceeds the apparent consideration for the same by not less than 25% of the apparent consideration, it shall be the conclusive proof that the consideration for the transfer agreed to between the parties has not been truly stated in the instrument of transfer. But in cases where the property has been transferred for an apparant consideration which is less than its market value, it would be presumed, unless the contrary is proved, that the consideration for such transfer as agreed to between the parties has not been truly stated in the instrument of transfer (I) with the object of facilitating the reduction or evasion of the liability to income-tax in respect of the income arising from the transfer ; or (ii) with the object of facilitating the concealment of any income or any moneys or other assests by the transferee for income-tax or wealth tax purposes.

Issue of Preliminary Notice (Section 269 D) : The competent authority must initiate proceedings for the acquisition of any immovable property by notice to that effect published in the Official Gazette. This Notice to initiate the proceedings must, however, be given before the expiry of a period of nine months from the end of the month in which the instrument of transfer in respect of the immovable property is registered. But in cases where the jurisdiction of a competent authority is in dispute and the competent authority who has originally initiated the proceedings of the Board subsequently determines the question of jurisdiction, the competent authority having jurisdiction may initiate the proceedings within a period of (i) nine months as mentioned earlier or (ii) within thirty days from the date of determination of jurisdiction of the competent authority, whichever is later. However, in cases where the proceedings for the acquisition of any immovable property could not be initiated within the prescribed period specified above due to any injunction or order of any court prohibiting the initiation of such proceedings or preventing the examination of documents or other materials required to be examined for the purpose of determining whether such proceedings should be initiated, the duration of the continuance of the injunction or order, from tne day on which it was issued or made and till the date on which it was withdrawn shall be excluded in computing the period during which such proceedings may be initiated.

The notice for initiating the proceedings must be served by the competent authority on the transferor, the transferee, the person in the occupation of the

property (if the transferor, is not occupying the property) and on every person whom the competent authority knows to be interested in the property. The competent authority should also cause the notice to be published (i) in his office by affixing a copy thereof in a conspicuous place, and (ii in the locality in which the concerned immovable property is situated, by affixing a copy thereof to a conspicuous part of the property and also by making known in the prescribed manner the substance of such notice at convenient place in the locality.

Objections (Section 269 E): Objections against the acquisition of the immovable property in respect of which a notice has been published may be made—

(i) by the transferor or transferee or any other person referred to in the proceeding paragraph, within a period of 45 days from the date of publication of the notice, or within 30 days of service of the notice on him, whichever is later ; or

(ii) by any other person interested in such immovable property, within 45 days from the date of publication of the notice.

In every case the objection must be made to the competent authority in writing. Under Section 269 C (2) (a) where the fair market value of the immovable property exceeds the apparent consideration by more than 25% of the apparent consideration it shall be a conclusive proof of the fact that the consideration for the transfer has been understated. Even in these cases an objection could be made in writing to the competent authority on the ground that the fair market value of the property does not exceed the apparent consideration therefor by more than 25% of such apparent consideration.

Hearing of Objections (Section 269 F) : On receipt of an objection, the competent authority must fix a day and place for the hearing of the objection made against the equisition of any immovable property and notice of the same must be given to every person who had made an objection. The notice should also be given to the transferee of the property irrespective of the fact whether he had made an objection or not. Every person to whom a notice is given by the competent authority has got the right to be heard at the time of hearing the objections. The competent authority is also vested with the power to adjourn the hearing to make such further enquiries as may be necessary and decide the matter on the basis of the objections, hearing, enquiries etc. After arriving at the decision the competent authority must communicate its decision in writing and state the reasons for the decision in respect of each objection. After the hearing of all the objections, if any, and after taking into account all the relvant materials on record, if the competent authority is satisfied that—

(i) the immovable property to which the proceedings relate is of a fair market value exceeding Rs. 25,000 (Rs. 1,00,000 w.e.f. 1.6.1984) ;

(ii) the fair market value of the property exceeds the apparent consideration therefor by not less than 15% of the apparent consideration ; and

(iii) the consideration for the transfer as agreed to between the parties has not been truly stated in the instrument of transfer with the object to tax avoidance or evasion, he may, after obtaining the approval of the Commissioner, make an order for the acquisition of the property.

Where the competent authority is not satisfied as aforesaid, he should declare in writing that the property will not be acquired. In either of these cases, the competent authority must serve a copy of his order on the transferor, the transferee and on every person who has made objections against such acquisition. However, in any proceedings for the acquisition of any immovable property, no objection would be entertained on the ground that although the apparent consideration for the property is less than the fair market value of the property on the date of the execution of the instrument of transfer or where it is rights acquired through membership of societies etc. on the date of transfer, the consideration as agreed to between the parties has been truly stated in the instrument of transfer because such consideration was agreed to having regard to the price that such property would have ordinarily fetched on such transfer in the open market or the date of the conclusion of the agreement to transfer the property, except in a case where the agreement has registered under the Registration Act, 1908.

Appeals to the Tribunal (Section 269 G): The order of the competent authority for the acquisition of any immovable property is appealable and the appeal, if preferred should be made directly to the Appellate Tribunal. The appeal, should be made by the transferor or the transferee or any other person who raised an objection against the acquisition within a period of 45 days from the date of the order or a period of 30 days from the date of service of a copy of the order on such person, whichever is later. Any other person who is interested in the property may also prefer an appeal against the order of acquisition within 45 days from the date of the order. If, however, the appellant satisfies the tribunal that he could not file the appeal within the prescribed time due to sufficient cause, he may apply to the tribunal within the period of 45 days or 30 days as the case may be, seeking permission for filing the appeal within a further period to be specified in the application. On receipt of an application, the Tribunal may if it is satisfied with the reason given by the applicant extend the time for filing the appeal specifying the period upto which the extension has been granted.

All appeals must be made in the prescribed form and must be verified in the prescribed manner and should be accompanied by a fee of Rs. 200. The Tribunal shall fix a day and place for the hearing of the appeal and shall give notice of the same to the appellant as well as the competent authority. After giving the appellant and the competent authority an opportunity of being heard, the Tribunal may pass such orders on the appeal as it thinks fit. The Tribunal is also entitled to amend its order within 30 days for the purpose of rectifying any mistake apparent from the record and is even bound to rectify the mistake in cases where it is brought to its notice by the appellant or the competent authority. However where, any such amendment is likely to affect any person prejudicially, the amendment can be made only after giving the person concerned reasonable opportunity of being heard. The orders passed by the Tribunal shall be sent to the appellant as well as the Commissioner. The decision of the Tribunal shall be final except in cases where questions of law are involved or they arise from the Tribunal's order. Specific provision has been made to the effect that the Tribunal should dispose of the appeals as expeditiously as possible and endeavour must be made to dispose of every such appeal within 30 days from the date of its presentation. The provisions of Section 255 [Except sub-section (3)] would be followed by the Tribunal in the matter of disposing of the appeal.

Appeal to the High Court. (Section 269 H): The Commissioner or any person aggrieved by the order of the Tribunal may prefer an appeal against

such order to the High Court on any question of law. The appeal to the High Court should be filed within 60 days from date on which he was served with the notice and the Tribunal's order. However the High Court may permit the appellant to file an appeal even later than 60 days. If the appellant satisfies the Court, after presenting an application within the time limit of 60 days seeking extension of the time limit and specifying the period upto which the extension is required, that he has been prevented by sufficient cause for not presen g the appeal within the time-limit of 60 days. If the Court permits the appellant the appeal can be filed within the time upto which the Court has given extension. The other procedural matter relating to the disposal of appeals by the High Court would be similar to other income-tax references.

Vesting of property (Section 269 (1) ; As soon as the other for acquisition of immovable property becomes final, the competent authority may by, issuing a notice in writing, order any person who may be in possession of the immovable property to surrender or deliver possession thereof, to the competent authority or any other person duly authorised in writing by the competent authority in this behalf, within thirty days from the date of service of the notice. For this purpose, an order for the acquisition of any immovable property is said to have become final

(i) in cases where the order for acquisition has not been appealed against to the Tribunal upon the expiry of the period during which the appeal may be presented;

(ii) in case where the order for acquisition has been made the subject matter of an apeal to the Appellate Tribunal—

(a) if the order of acquisition is confirmed by the Tribunal and the Tribunal's order has not been appealed against to the High Court, upon the expiry of the period of time allowed for appeal to the High Court;

(b) if the Tribunal's order has been made the subject matter of an appeal to the High Court, upon the confirmation of the order for acquisition by the High Court.

Where any person refuses or fails to comply with the notice of the competent authority, the authority concerned or any other person duly authorised in this behalf may take possesion of the immovable property and may, for that purpose, use such force as may be necessary. In addition, the competent authority may, for the purpose of taking possession of the property, requisition the services of any police officer to assist him and it shall be the duty of the police officer to comply with such requisition.

Immediately after the possession of the property is taken over either by the competent authority or by any person authorised in this behalf, the property shall vest, absolutely in the Central Government free from all encumbrances. But the transferee or any other person (other than the Central Government) would not in any way get discharged from the liability in respect of such encumbrances and, notwithstanding anything to the contrary, contained in any other law such liability may be enforced against the transferee or such other persons by a suit for damages. In case of rights in buildings (completed or partial) acquired through membership in cooperative societies, companies etc., the final order by the com-

petent authority will vest such rights in the Central Government and it will place the Central Government in the same position in relation to such rights as the person in whom such rights would have continued to vest, if such order had not become final. The competent authority may issue such directions as he may deem fit to any person concerned for taking the necessary steps for compliance with the above provisions. The discussion in the above paras will apply in regard to rights in building (completed or partial).

Compensation (Section 269 J): In all cases where any immovable property is acquired, the Central Government must pay for such acquisition compensation of a sum equal to the aggregate of the amount of apparent consideration plus 15% of the apparent consideration.

Where the whole or part consideration is payable after the date of acquisition of the property, the compensation shall be the aggregate amount of the following :

(1) 15% of apparent consideration

(2) the amount that has become payable as per agreement on or before the of acquisition

(3) the amount is payable after the date of acquisition.

In cases where after the transfer of the property to the transferee but before its vesting in the Central Government the property has been damaged (otherwise than as a result of normal wear and tear) the compensation payable to the transferee must be reduced by such amount as the competent authority and the persons entitled to the compensation may agree within 15 days of the vesting of the property in the Central Government. If no such agreement is arrived at within the 15 days as aforesaid, the matter may be referred to the Court by the competent anthority or ony other person duly authorised by the competent authority for this purpose and the Court may determine the amount that may have to be expended for restoring the property to the condition in which it was at the time of its original transfer.

However in cases where, after the transfer of the property to the transferee but before the date of publication of the notice in the Official Gazette, any improvements have been made to the property, whether by means of addition or alteration or any other manner, the compensation payable in respect of the property shall be increased by such amount as the competent authority and the persons entitled to the compensation may agree within 15 days of vesting of the property in the Central Government. If there is default in arriving at such an agreement within 15 days as aforesaid, the court may determine the amount spent for making such improvement on receipt of a reference made by the competent authority or any person authorised for this purpose. The reference to the Court in this regard should normally be made within 30 days from the date on which the property vests in the Government except in cases where on receipt of an application within the period of 30 days, the Court has granted extension of time for making the reference.

The amount by which the compensation payable in respect of any immovable property acquired by the Government falls short of the amount which would

have been payable as compensation if that property has been acquired under the Land Acquisition Act shall be deemed to have been realised by the Central Government as a penalty from the transferee for being a party to a transfer with the object of avoidance or evasion of tax. Further, no penalty under Section 271 (1)(c)(ii) of the Income tax Act and Section 18(1)(iii) of the Wealth-tax Act shall be levied on the transferee for concealing the particulars or fu shing false or inaccurate particulars of so much of his income or assets as is/are utilised by him for paying to the transferor, by way of consideration for the property and amount in excess of the apparent consideration for the property. This does not, however, affect the inclusion of the amount of such excess in the taxable income or net-wealth of the transferee.

Payment of Compensation (Section 262 K) : The amount of compensation for the acquisition of any immovable property must be tendered to the persons entitled thereto as soon as the property becomes vested in the Central Government. Where the whole or part of the consideration is payable after the date of acquisition, then 15% of apparent consideration and the amount payable as per the agreement between the parties, on or before the date of acquisition will be tendered as soon the property becomes vested in the Central Government. The balance payable will be tendered on the date on which it would be payable in accordance with the agreement between the parties. In cases, where a reference has been made to the Court for determination of the amount by which the compensation payable should be reduced or increased the compensation as reduced or increased by the Court shall be paid by the Government. Where any dispute arises in regard to the apportionment of the compensation amongst the persons who claim to be entitled for the same, the Central Government must deposit the compensation amount in the Court and refer such dispute for the decision of the Court and in all such cases the decision of the Court shall be final. If the person entitled to the compensation do not consent to receive it, or if there is no person competent to alienate the immovable property, or if there is any dispute as to the title to receive the compensation the Central Government shall deposit the compensation amount in the Court and refer the matter for the decision of the Court. However, these provisions do not in any way affect the liability of any who may receive whole or any part of the compensation for any immovable property acquired by the Government to pay the same to the person who is lawfully entitled thereto.

If the Central Government fails to tender or deposit whole or any part of the compensation as aforesaid within a period of 30 days from the date on which the immovable property to which the compensation relates becomes vested in the Central Government the Central Government is liable to pay the same together with simple interest at 12% p.a. on the outstanding amount. The interest for this purpose should be calculated from the day following the date of expiry of the thirty day's period aforesaid upto the date on which outstanding amount of compensation is actually paid or deposited. Where the amount of compensation together with the interest, if any, has been deposited in the Court, the Court may, either on its own or on the basis of an application made by or on behalf of any party interested in the compensation amount order the same to be invested in such Government or other securities as it thinks proper, and may direct such manner as well in, its opinion give the parties interested therein the same benefit therefrom as they might have had from the immovable property in respect of which the amount has been deposited or as near thereto as may be.

Assistance by Valuation Officer (Section 269 L) : The competent authority is entitled to require a Valuation Officer to determine the fair market value of the immovable property and report to him both for the purpose of initiating proceedings for the acquisition and for the purpose of estimating the increase or reduction to be made in the amount of compensation payable in respect of the property. The Valuation Officer will be entitled to exercise all this powers that he has under Section 38A of the Wealth-tax Act. Valuation Officer means a valuer appointed under Section 4 of the Estate Duty Act. In an appeal against the order for acquisition of any immovable property, if the market value of the property is in dispute on receipt of the request from the competent authority made in this behalf, the Appellate Tribunal shall give an opportunity of being heard to any Valuation Officer nominated for this purpose by the competent authority.

Other Provisions (Section 269 M to 269 S) : For all purposes of acquisition of immovable property, the competent authority shall have all the powers that a Commissioner has under Secton 131 of the Act. Mistakes apparent from the record requiring amendments in the order may be rectified by the competent authority under Section 269 B at any time before the expiry of the time for presenting an appeal against the order. The rectification can be made by the competent authority either on his own motion or on the mistake being brought to his notice by the order. Where the amendment is likely to affect any person prejudicially, the amendment can be made only after giving the person a reasonable opportunity of being heard. The persons who are required to attend before the competent authority or the Tribunal (except when they are required to attend personally for being examined on oath or for affirmation) may attend by an authorised representative or by a registered valuer.

All registering officers appointed under the Registration Act 1908 are statutorily obliged to register any document purporting to transfer any immovable property belonging to any person *only if* a statement in duplicate in respect of such transfer, in the prescribed form, verified in the prescribed manner, and setting forth all such particulars as may be prescribed, is furnished to him along with the instrument of transfer. However, with effect from 1st January, 1974, the registering officer may register the document of transfer of immovable property in all cases where the apparent consideration does not exceed Rs. 10,000 (Rs. 50,000 w.e.f. 1-6-84). The registering officer is bound, at the end of every fortnight, to forward to the competent authority (i) one set of the documents received by him as aforesaid during the fortnight ; and (ii) a return in the prescribed form verified in the prescribed manner and setting forth such other particulars as may be prescribed in respect of the documents registered by him during the fortnight.

It has been expressly made clear that these provisions relating to acquisition of immovable property shall not apply to any transfer made by a person to his relatives on account of natural love and affection for a consideration which is less than fair market value of the property. The exception is, however, subject to the condition that the instrument of transfer contains a specific recital to the effect that the transfer has been made to the relative out of love and affection. The provisions for acquiring immovable property discussed in the earlier paragraph do not apply to properties located in the state of Jammu and Kashmir. Properties which are liable for requisition under the Income-tax Act are not also so liable for acquisition

under the Land Acquisition Act or other law unless the time limit for the initiation *of proceedings for the acquisition of such property under the Income-tax* **Act has** expired without any such proceedings having been taken or unless the competent authority has declared in writing that such property will not be acquired under the Income-tax Act.

CHAPTER XXB

6. **Mode of taking or accepting certain loans and deposits :**

The Finance Act, 1984 has inserted a new section 269SS in Chapter XXB with effect from 1-4-84. Accordingly no person shall accept any loan of Rs. 10,000 or more from any other person exccept by account payee cheque or account payee bank draft. This requirement also applies in cases where on the date of taking or accepting a loan or deposit from a person, any earlier loan or deposit taken or accepted from the same person and remaining unpaid on that date, is ten thousand Rupees or more. The requirement also applies if the aggregate amount of such earlier loan or deposit and the amount of loan or deposit proposed to be taken or accepted from that person is ten thousand rupees or more.

The requirement will not, however, apply to loan or deposit taken or accepted from, or any loan or deposit taken from or accepted by Government, any banking company, post office saving bank or any cooperative bank : any corporation established by a Central, State or Provincial Act ; or any Government company as defined in Section 617 of the Companies Act, 1956. The provisions of the new Section will also not apply to any loan or deposit taken, or accepted from, or any loan or deposit taken from or accepted by, any institution, association or body which the Central Government may, for reasons to be recorded in writing notify in this behalf.

The expression "loan or deposit" in this section will mean any loan or deposit of money.

Even though the Section is effective from 1-4-1984, the requirement laid down under the proposed Section will apply only in relation to loans and deposits taken or accepted after 31-6-84.

If a person without reasonable cause or excuse, takes or accepts any loan or deposit in contravention of the provisions of Seetion 269SS, he shall be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine equal to the amount of such loan or deposit (Section 276DD).

Mode of repayment of certain deposits

Section 269T in this chapter provides for the mode of repayment of certain deposits. *Under this provision no company including a banking company, cooperative* society or firm shall repay to any person any deposit or otherwise by an account payee cheque or account payee bank draft where the amount of the deposit or where the amount of deposit is to be repaid together with any interest,

the aggregate of the amount of deposit and such interest, is Rs. 10,000/or more. Where the repayment is made by a banking company or a cooperative bank, such repayment would also be made by crediting the amount of such deposit to the account if any with such company or bank of the person to whom such deposit has to be repaid.

Sub-section (2) of Section 269T, provides that no branch of the banking company or a cooperative bank or any other company or cooperative society or a firm shall repay any deposit made with it otherwise than by account payee cheque or account payee bank draft, drawn in the name of the person who has made the deposit if the amount of the deposit together with interest if any payable thereon or the aggregate amount of such deposit held by such person with the branch of the banking company or cooperative bank or as the case may be, the other company or cooperative society or the firm, either in his own name or jointly with any other person on the date of such repayment, together with the interest if any payable on such deposits is Rs. 10,000-or more. However, if the repayment is made by a branch of a bank or a cooperative bank such repayment could be made by crediting the amount of such deposit to the savings bank account or the current account, if any, with such branch of the person to whom such deposit has to be repaid.

For the purposes of this section and 269SS following the expression "banking company" will have the meaning assigned to it in clause (a) of the Explanation to Section 40A (8) of the Income-tax Act. The expression "cooperative bank" will have the meaning assigned to it in Part V of the Banking Regulation Act, 1949.

Special Bearer Bonds

Section 269TT similarly provides that the amount payable on redemption of Special Bearer Bonds 1991 shall be paid only by an account payee cheque or account payee bank draft drawn in the name of the person to whom such repayment is to be made.

Failure without reasonable cause or excuse, to comply with the provisions of Section 269T will be punishable with imprisonment for a term which may extend to two years and a fine equal to the amount of the concerned deposit. This is provided in the new Section 276E.

Certain consequential amendments have also been made in Section 278A and 279 with a view to making a reference so Section 276E also in those provisions.

TAX CREDIT CERTIFICATE : (Section 280Y to ZE).

General : The provisions relating to tax credit certificates were introduced with a view to encouraging industrial growth. The assessee is entitled to receive a certificate if he fullfills the prescribed conditions laid down in the appropriate Section. The tax credit certificate can be utilised by the assessee to settle or adjust his liabilities to tax and may also be exchanged for a cash refund in certain circumstances. Since the tax credit certificate schemes envisaged in Section 280Y to ZE are not in operation now, excepting Section 280/ZA, they have got only academic importance and hence not been covered in this study. The different types of tax credit certificates that may be issued by the Governments are the following.

Tax Credit Certificates for shifting of industrial undertaking from urban areas : Section 280ZA provides for the grant of the tax credit certificate under the following conditions :

(i) It is granted only to a company, whethe. public or private, which shifts with the prior approval of the Central Board of Direct Taxes its industrial undertaking from an urban area (notified by the Central Government under the Tax Credit Certificate (Shifting of Industrial Undertakings) Scheme, 1967(1667)65 I.T.R. (St) 90 to any other area and incurs liability for payment to tax on the 'Capital gains" derived from the sale of lands and buildings or any rights therein used for the purpose of its business in the urban area.

(ii) The amount of the tax credit certificate will be calculated as that proportion of the tax payable on the "capital gains" which the expenditure incurred by the company in acquiring lands or constructing buildings for the purpose of its business in the area and on the shifting of its machinery or plant and other areas and transferring its establishment to such area within a period of *three years* from the date of the Board's approval to the shifting, bears to the "capital gains" derived from the sale of its lands and buildings in the urban area as stated above.

(iii) If the investment in lands and buildings in the new area, including the expenditure of shifting, as stated above, is equal to or exceeds such "captial gains" the tax credit certificate will be granted for the amount of tax payable on the "capital gains".

(iv) The period of three years may be extended by the Board in suitable cases.

(v) If the company transfers the lands or buildings in the new area within a period of *five years* to a person, other than the Government or a public sector corporation, an amount equal to one half of the amount of the tax credit certificate will be taken back from the company.

(vi) Any land and buildings used for the purposes of the residence and use of employees of the company in its business *e.g.*, hospital, school canteens, rest-rooms, lunch rooms, etc., for purpose of this Section shall be deemed to be lands and buildings used for the purpose of the business of the company.

The Finance Act 1983 has amended section 280ZA. Accordingly the capital gain arising from the transfer of machinery and plant would also be taken into account for the purpose of granting tax-credit certificate and expenditure incurred for purchasing new machinery or plant for the undertaking in the area to which the undertaking is shifted will also qualify for being considered in computing the amount of tax-credit certificate. If the new machinery or plant is transferred within 5 years of its purchase, one half of the amount for which the tax credit certificate has been granted to the company will be deemed to be the tax due from the company.

This amendment will be effective from the assessment year 1984-85 onwords.

Tax Credit Certificate Scheme : General powers of the Central Govt. : In addition to the specific scheme for the grant of tax credit certificate stated

above Section 280 ZE empowers the Central Government to frame one or more schemes by notification in the Official Gazette in relation to tax credit certificates to be granted to the assessee. Any scheme framed by the Central Government under this Section shall, in particular, provide for :

(i) the form and manner in which and the authority to which applications for the grant of tax certificates shall be made ;

(ii) the from in which and the intervals at which and the authority by which such certificates shall be issued ;

(iii) the verification of any information or particulars furnished or contained in an application made by or on behalf of any person entitled to tax credit certificates ;

(iv) the determination of the rights and obligations of a person to whom the certificate has been granted and the circumstances under which any right or title to the certificate may be transferred to or devolve upon any other person by succession, inheritance or otherwise ;

(v) the determination of the rights and obligations of the persons who jointly subscribe to an eligible issue of capital or the rights and obligations of persons who subscribe to an eligible issue of capital on behalf of or for the benefits of any other person ;

(vi) the appointment of any officer of the Government or the Reserve Bank to exercise any right or to perform any duties in regard to the grant of tax credit certificates ;

(vii) the goods or merchandise and the rate or rates for the purpose of Section 280ZC and 280ZD and the destination of report of such goods or merchandise for the purpose of Section 280ZC ; and

(viii) any other matter which may be necessary or proper for the effective implementation of the provisions of the Act regarding tax credit certificates.

Further, the Central Government may, by notification in the Official Gazette, amend, vary or rescind any of the schemes for granting tax credit certificates framed by it under the Section with the sanction of both the Houses of the Parliament.

7. MISCELLANEOUS PROVISIONS (Sections 281 to 295) :

Transfers to Defraud Revenue Void (Sections 281) ; As a safeguard against non-realisation of revenue due to fraudulent transference of assets by a defaulting assessee it is provided under this Section that, certain transfers specified therein are deemed to be void for purposes of income-tax. Accordingly, in cases where, during the pendency of any proceeding under the Income-tax Act or after the completion thereof, but before the service of notice by the Tax Recovery Officer any assessee creates a charge on, or part with, the property by way of sale, mortgage, gift, exhange or any other mode of transfer whatsoever of any of his assets in favour of any other person such a charge or transfer must be deemed to be void as against any claim in respect of any tax, penalty, interest or fine payable by the assessee as

a result of the completion of the proceedings or otherwise. However, the charge or transfer made by the assessee would not be void in case where it is made.

(a) for adequate consideration and without any notice of the pendency of such proceedings or, as the case may be, without any notice of such tax or other monies remaining payable by the assessee ; or

(b) with the previous permission of the Income-tax Officer

This new provision applies to all cases where the amount of tax or other sum of money which is payable or likely to be payable exceeds Rs. 5,000 and the assets which are charged or transferred by the assessee exceed Rs. 10,000 in value, in the aggregate. For this purpose, the term 'assets' should be taken to mean land, buildings, machinery, plant, shares, securities and fixed deposits in bank to the extent to which any of these assets do not form part of the stock-in-trade of the business carried on by the assessee. In other words, if these items of properties represent the stock-in-trade of the assessee's, business, their transfer would not be treated as void.

Special Provisions to curb benami holdings of property (Section 281A) *Position upto 83-84 assessment year* : This special provision seeks to ensure that no person shall be legally entitled to claim to be the real owner of any property held benami or any right in respect thereof unless :

(i) The income, if any, from that property has been properly disclosed in the return of income furnished by the claimant under Section 139 of the Act ; or,

(ii) The value of such property has been duly disclosed in the claimant's return of net-wealth for purposes of wealth-tax assessment ; or,

(iii) The prescribed notice in Form No. 53 containing the required particulars has been duly given by the claimant to the Income tax Officer in accordance with Rule 123 of the Income-tax Rules.

Section 281A thus seeks to restrain the real owner from exercising his rights of ownership in the case of benami holdings, as benami holdings are often resorted to by the tax-payers to evade taxes.

For the purposes of the section, it is immaterial whether the real owner i.e., the claimant seeks to enforce his claim in respect of the properties held benami against any other person in whose name the properties are held i.e., the benamidar or against any other person ; it is equally immaterial whether the claim is sought to be enforced in a court of law by the real owner himself or by any other person on his behalf.

The provisions of Section 281A shall not, however, apply to any claim made by the real owner of property through a suit the value of which does not exceed Rs. 2,000 where the suit is tried by—*(i)* a Court of Small Causes, or *(ii)* a court invested with the jurisdiction of Small Causes, by or under any law for the time being in the exercise of such jurisdiction.

Amendment by Finance Act, 1984 (w.e.f. 1.4.84)

The Finance Act, 1984 has done away with the option available to the real owner of making a disclosure in the return of income or net wealth. Hence-

forward the real owner, *in all cases*, has to give a notice in the prescribed form containing the prescribed particulars in respect of the property within a period of one year from the date of acquisition of the property to the commissioner of Income-Tax.

Where such benami acquisitions of property is made before 1.3.84 the above requirement shall be deemed to have been fulfilled if, notice in the prescribed form and containing the prescribed particulars in respect of the property is given by the claimant (person claiming to be the real owner) within a period of one year from that date to the commissioner of Income-tax.

Where the value of any suit relating to any immovable property does not exceed Rs. 50,000, the above requirement shall be deemed to have been fulfilled if, at any time, before the suit, notice in the prescribed form and containing the prescribed particulars in respect of the property is given by the claimant to the commissioner of Income Tax.

The Commissioner of Income-tax shall, on an application made in the prescribed manner by the claimant or any person acting on his behalf, or claiming under him, and on payment of the prescribed fees issue for the purposes of a suit a certified copy of any notice given by the claimant under any of the above requirements within 14 days from the receipt of the application.

Provisional attachment to protect the interest of the revenue: (Section 281B) According to this section, cases where, during the pendency of any proceeding for the assessment of any income or for the assessment or re-assessment of any income which has escaped assessment, the Income Tax Officer is of the opinion that, for the purpose of protecting the interest of the Revenue, it is necessary to do so, he may, by an order in writing, attach provisionally any property belonging to the assessee. However, before passing an order, the Income Tax Officer is required to take the prior permission of the Commissioner of Income-tax. The attachment in all such cases should be in the same manner as is provided under the rules laid down in the Second Schedule to the Income-tax Act. Every provisional attachment would cease to be effective after the expiry of a period of six months from the date on which the order for the attachment is passed by the Income Tax Officer. However, the Commissioner is entitled, for reasons to be recorded in writing, to extend the validity of the period during which the order for attachment would be operatative by such further period or periods as he deems fit. But, in no case shall the total period of provisional attachment of the property exceed two years from the date of the original order of the Income Tax Officer.

Service of Notice (Section 282 to 284): Notices or requisitions under the Act may be served on the person concerned by post or as if it were a summons issued by a Court under the Civil Procedure Code. Following is a list of persons on whom notice should be served and such a notice will be notice to the corresponding assessee mentioned.

Assessee	Addressee
(i) An existing firm	Any member
(ii) An existing H.U.F.	Karta or manager or any adult member

(iii) A company	*Principal Officer*
(iv) **Local authority**	**Principal Officer**
(v) An existing association of persons	Principal Officer or any member
(vi) An individual	The individual himself
(vii) Any other person	The person incharge of the management and control of his affairs
(viii) A dissolved firm	Any adult person who was a partner immediately before dissolution
(ix) A deceased, mentally incapacitated, or insolvent individual.	The legal heir, executor, guardian receiver or administrator
(x) A partitioned H.U.F.	Last manager or Karta ; if he is dead, all adults who were members immediately before the partition
(xi) A dissolved association of persons	Any person who was a member immetely before dissolution
(xii) A discontinued business	The assessee ; or in the case of a firm or an association of persons, any person who was a member at the time of discontinuance or in the case of a company, its principal officer.

Other Information (Sections 285 and 286): Under Section 285 read with Rule 116 any person responsible for paying any interest other than interest on securities has the obligation to furnish a return every year to the I.T.O. in the prescribed form of the names and addresses of persons to whom interest of not less than Rs. 400 was paid by him during the previous financial year. The return is to be filed before the 15th day of June every year in Form No. 50 containing the prescribed particulars.

Likewise, under Section 286 and Rule 117 the principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of dividends within India shall have to furnish before 15th June every year a list of all the company shareholders to whom dividends has been paid during the previous financial year and also of non-company shareholders to whom dividends in excess of Rs. 5,000 in the aggregate, had been paid during the said year. The return should be made in Form No. 51 in the prescribed manner.

Information by Contractors (Section 285A) : Under Section 285A read with Rules 120 and 121 any person entering into a contract for the construction of a building or for the supply of goods or services in connection therewith to any other person, for a sum exceeding Rs. 50,000 (either individually or in the aggregate) is required to furnish, within thirty days of making the contract to the I.T.O. the prescribed particulars regarding the contract in Form No. 52. Any

contravention of this provision makes the contractor liable to a fine to be imposed by the Commissioner. The amounts of such penalty may be upto Rs. 50 for each day of default but the maximum amount of fine, however, shall not exceed in the aggregate 25% of the value of the contract.

Submission of Statements by Producers of Films : [285B] This section provides that any person who carries on the production of a cinematograph film during the whole or any part of any financial year is under a statutory obligation, with respect of the period during which such production is carried on by him during the financial year to prepare and deliver or caused to be delivered to the Income-tax Officer within 30 days from the end of the financial year or within 30 days from the date of completion of the production of the film, whichever is earlier, a detailed statement in the prescribed form containing the particulars of all the payments exceeding Rs. 5,000 in the aggregate made by him or due from him to each person who is/was engaged in the production of the film in his capacity as an employee or otherwise.

Publication of Information. (Section 287) : The Central Government is empowered to publish the name and address of any assessee and other particular relating to them, if it considers it necessary or expedient in the public interest to do so. But no such publication relating to any penalty or prosecution shall be made until the time for presenting appeal to the A.A,C. or the first appelate court as the case may be has expired without an appeal having been presented or until the appeal, if presented, has been disposed of. In the case of a firm, company or other association of persons the names of the partners of the firm, directors or manager of the company or members of the associations, as case may be, may also be published if, in the opinion of the Central Government, the circumstances of the case justify the same.

Appearance by Registered Valuers (Section 287A) : Any tax payer who is entitled to or required to attend before any income tax authority or the Appellate Tribunal in connection with any matter relating to the valuation of any asset, otherwise than when he is required under Section 131 to attend personally for examination on oath or affirmation, may attend by a registered valuer. For this purpose, a registered valuer means a person who is registered as a valuer Section 34 AB of the Wealth tax Act.

Authorised Representative (Section 228) : Any assessee who is entitled or required to attend before any authority under the Act or the Appellate Tribunal in connection with any proceeding under this Act may attend by an authorised representative. But where personal attendence is required under Section 131, the person must attend himself. Sub-section (2) enumerates a list of persons (including Chartered Accountants, legal practitioners, who are not guilty of professional misconduct, persons related to or employed by the assessee) who may be authorised by a person to attend on behalf of the later. Rules 49 to 66 regulate the provisions regarding appearance by authorised representative.

Rounding off of income-tax etc. (Section 288A and 288B) : The total income of any assessee shall be rounded off to the nearest ten rupees. The amount of tax including tax deductible at source or payable in advance, interest, penlty fine or any other sum payable under the Act and the amount of any refund shall be rounded off to the nearest rupee.

Receipt (Section 289) : The Department or the person or authority receiving any money paid by or recovered from the assessee or any other person shall issue a receipt for the same.

Indemnity (Section 290) ; Every person deducting retaining or paying any tax in pursuance of this Act in respe(.f income belonging to another person is entitled to be indemnified for the deduction, retention or payment thereof.

Power to tender immunity from prosecution (Section 291): The Central Government is empowered by Section 291 to tender any person immunity from prosecution for any offence under this Act if it is of the opinion that it is necessary or expedient in the public interest to do so for the purpose of obtaining the evidence directly or indirectly concerned in or privy to the concealment of the income or to the evasion of payment of tax on any income taxable under the Act. A tender of immunity made to or accepted by the person concerned shall, to the extent to which the immunity extends, renders him immune from prosecution for any offence in respect of which tender was made or from the imposition of any penalty under Act.

Cognisance of offences and bar of suits in Civil Courts (Sections 292 and 293) : No suit can be brought in any Civil Court to set aside or modify any assessment order and no prosecution, suit or other proceedings shall lie against any Government Officer for any thing done or intended to be done by him in good faith under the Act. No Court inferior to that of a Presidency magistrate or a Magistrate of the first class shall try any offence under this Act.

Certain Laws not to apply ; (Section 292A) provides that the provisions of Section 360 of the Code of Criminal Procedure, 1973 or the Probation of Offenders Act, 1958 shall not be applicable to any person who is convicted of an offence under the Income tax Act, unless that person is below 18 years of age.

Return ef income etc. not to become invalid : Section 292B provides that no return of income, order of assessment, notice, summons or other proceedings furnished or made or taken or purported to have been furnished or made in puruance of any of the provisions of the Income tax Act, shall be invalid or shall be deemed to be invalid merly by reason of any mistake, or omission in such return of income, assessment order or notice, etc., if they are in substance and effect in conformity with or according to the intent and purposes of the Income tax Act. The provision thus enable tax authorities to accept returns and other documents and also makes it applicable for tax payers to accept orders, notice, etc., received from tax authorities even in cases where a few typographical, arithmetical or other mistakes which do not materially affect the objects with which the Document was submitted by the assessee or order was issued by the department. [Refer also to Section 139 (9) explained in Study VI].

Concessions for encouraging participation in the business of prospecting for extraction etc., of mineral oils (Section 293A) : With a view to encouraging the foreign companies to participate in the business of oil exploration and production, the Central Government is empowered under Section 298A to make by a notification in the Official Gazetlee, an exemption, reduction in rate or other modification in respect of income-tax in favour of any class of persons speci-

fied below, if it considers it necessary or expedient so to do in the public interest namely :—

(i) persons with whom the Central Government has entered into agreements for the association or participation of that Government or any person authorised by that Government in any business consisting of prospecting for, ar extraction or production of, mineral oils :

(ii) persons providing any services or facilities in connection with any business consisting of the prospecting for or extraction or production of mineral oils carried on by that government or any person notified by it in this behalf or those supplying any ship, aircaft, machinery or plant in connection with such business, whether by way of sale or hire : and

Rules (Section 295 and 296) : Section 295 authorises the Central Board of Direct Taxes to make rules for the whole or any part of India for carrying out the purposes and to implement the provisions of the Act. The powers of the Board in this regard are subject to the supervision and control of the Central Government. The rules framed by the Board and approved by the Central Government are required to be placed before each House of the Parliament before enforçing the same. In exercise of the powers conferred on it by this Section, the Boards with the approval and sanction of the Central Government and the Parliament, has framed the Income tax Rules, 1962 which have been amended from time to time. This Section also enumerates the important matters on which rules may be framed by the Board ; the Rules framed under this Act have the same force of the Section of the Act. The rules must be interpreted in the light of the Sections under which they have been made. But the rules should be so framed as not to adversely affect or derogate from the full operative effct of the provisions of the Sections. The rules must be within the term of the mandate given to the Board and must bh framed in such a way as to be consistent with and supplementary to the provisions of the Act.

8. THE PUBLIC PROVIDENT FUND SCHEME

General : With a view to mobilising personal savings and to provide a channel for the collection of long-term savings from all the sections of the community, particularly self-employed persons, the Central Government has constituted a Public Provident Fund scheme under the Public Provident Fund Act, 1968. The scheme came into operation with effect from 1st July 1968. [(1968) 69 I.I.R. (St.)].

Membership : The membership of the fund is open to every individual who may subscribe to it either in his own name and/or on behalf of a minor of whom he is the guardian. Assesssees, other than individuals, are not entitled to the membership of this scheme. The scheme is being handled by the State Bank of India and its subsidiaries as well as Head Post-Offices. There is a pass book for each account.

Subscripitons : In any financial year a person can subscribe amounts ranging from a minimum of Rs. 100 to a maximum of Rs. 30,000. The subscription can be paid in multiples of Rs. 5 in as many instalments as the subscriber chooses ; but in a calender month only one instalment can be paid. The subscription can be

paid at any office or branch of the State Bank of India and its subsidiaries. The branch or office at which the amounts are deposited will maintain an account of the deposits made by the subscriber, will grant him a certificate in respect of the subscriptions paid during the year and will issue him a pass book showing the balance standing to his credit.

The balance to the credit of the subscriber shall carry simple interest at the rate notified by the Central Government. The prssent rate of interest is 9% p.a. tax-free. The interest is calculated for each calender month, on the lowest balance standing to the credit of the subscriber between the 5th and the last day of each month and is credited to the account of the subscriber at the end of each year. The amount of interest so calculated shall be rounded off to the nearest rupee. The amount standing to the credit of a subscriber shall not be liable to attachment under any decree or order of any Court in respect of any debt or liability created or incurred directly or indirectly by the subscriber.

Partial withdrawals & Loan Facilities : Under the P.P.F. Scheme, partial withdrawls from the account can also be made. First, withdrawal can be made in the 7th, 9th or 10th Financial Year upto 50% of the balance at the credit (inclusive of interest) at the end of the 1st, 2nd, 6th, 3rd or 4th Financial Year respectively. Second withdrawals can be made in the 11th, 12th, 13th or 14th financial year upto 50% of the balance at the credit (inclusive of interest) at the end of the 5th, 6th, 7th or 8th financial year respectively. The third withdrawal can be made in the 15th or 16th Financial year upto 50% of the balance at the credit (inclusive of interest) at the end of the 9th or 10 financial year respectively.

Certain loan facilities, should the need arise, can also be availed of. First loan can be taken in the third financial year upto 25% of the amount to the credit at the end of the first financial year at the present effective rate of 9% repayable in 24 months. Second or subsequent loans can also be taken after the first or earlier loans are repaid fully with interest. No loan can be taken after the end of the sixth financial year, when, however, partial withdrawal is permissible.

Nomination : A subscriber to the fund is entitled to nominate any person or persons to receive the money standing to his credit in event of his death. However, no nomination is permissible in respect of any account opened on behalf of a minor.

Tax Concessions : Individual subscribers to the Public Provident Fund are entitled to some tax concessions as are available to the participants of the statutory or recognised provident funds. As a result, subscriptions to the fund qualify for tax relief by way of deductions from the gross total income, along with savings through other specified media such as life insurance policies statutory and recognised provident funds, approved superannuation funds and 10 years and 15 years accounts under the Post Office Savings Banks (Cumulative Time Deposits) Rules. It has been clarified by the Board that contributions made by a HUF to PPF account standing in the name of a member would be eligible for deduction under Section 80C. The tax concession, however, is subject to the overall qualifying limits prescribed by the Act. [Section 80C (2) (a) (iv)]. Under Section 10 (11), interest credited to the fund is totally exempt from tax and not limited to Rs. 7000 as under Section 80L. Any amount received from the fund also is exempt from

Income-tax in the hands of the recipients in the same manner as in the case of amounts received from the other provinent funds. Thus, the amounts received from this fund do not form a part of the total income of the assessee. [Section 10 (11)]. The monies standing to the credit of an individual in a Public Provident Fund Account would also be wholly exempt from wealth tax without being included in the list of financial assets qualifying for exemption upto Rs. 1,65,000.

SELF-EXAMINATION QUESTIONS

1. A person can withdraw the full amount of his contributions to the public provident fund at any time—

   (a) before the expiry of ten years (b) after the expirty of ten years (c) after the expiry of five years (d) during the same year (e) after the expiry of fifteen years.

2. The first withdrawal can be made after—

   (a) two years (b) five years (c) ten years (d) first year. ( )

3. The interval of time between any two withdrawals should be –

   (a) not less than two years (b) not more than three years (c) not less than three years (d) not more than five years. ( )

4. A loan taken by a member from his own contributions to the fund should be repaid —(a) within two years, (b) after five years, (c) within one year, (d) within ten years.

5. The rate of interest on the loan taken will be—

   (a) 6%p.a. (b) 4%p.a. (c) 9%p.a. (d) 12%p.a. (e) 2%p.a. ( )

6. The tax concession available in respect of contributions to Public Provident Fund is by way of—

   (a) exclusion from total income (b) full deduction from gross total income (c) rebate at the average rate of tax payable (d) partial deduction form gross total income.

7. Amount received from the fund are—

   (a) totally exempt from tax (b) included in the total income and qualify

9. The condition regarding tax clearance certificate under Sections 230A will apply in the case of transfer of immovable property valued at more than (a) Rs. 25,000 (b) 1,00,000 (c) Rs. 50,000.

ANSWERS

1. (e), 2. (b), 3. (c), 4. (a), 5. (e), 6. (d), 7. (a).

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

STUDY MATERIAL

F.S.P.
I. Tax—8

FINAL COURSE

INCOME-TAX

STUDY—VIII

Contents :

Companies (Profits) Surtax Act, 1964.

COMPANIES (PROFITS) SURTAX ACT, 1964

Applicability : All companies having a share capital are liable to pay surtax on the excess of their chargeable profits over the statutory deduction with effect from the assessment year 1964-65 under the Companies (profits) Surtax Act, 1964. The Act does not apply to those co ,anies which have no share capital as specifically provided by section 26 of the Act. Even a non-resident company is liable to be assessed under the provisions of the Act (Swadeshi East Asia Co. Ltd. V. C.I.T. (1981) 7 Taxman III (Cal).

Surtax and income-tax : The sur tax is payable by companies over and above the income-tax and the tax on capital gains, if any, payable by them.

Income-tax and surcharge thereon payable by a company are deductible from the total income for determinnig the chargeable profits. But for determining the assessable income under the income-tax Act the Surtax payable by the company is not deductible.

Surtax and additional income-tax : For determining the liability of a company for additional income-tax under sections 104 to 109 of the Income-tax Act, the surtax payable by the company is admissible as a deduction. But for determining the chargeable profits under the Surtax Act such additional income-tax is not deductible.

For computing the chargeable profits under the Surtax Act the basis is the *total income* of the company for the relevant assessment year as determined under the Income tax Act. Thereafter the adjustments mentioned in the first schedule to the Surtax Act should be made but for determining the liability to additional income tax of a closely-held company, the *gross total income* of the company as determined under Section 80B (5) of the Income-tax Act should be taken as the basis.

Important Terms

1. **Assessee :** Assessee means a person by whom surtax or any other sum of money is payable under this Act and includes every person in respect of whom any proceeding under the Surtax Act has been taken for (1) the assessment of his chargeable profits or (2) the assessment of the amount of refund due to him or (3) the assessment of the chargeable profits of any other person in respect of which he is assessable or (4) the assessment of refund due to such other person. [Section 2(1A)].

2. **Chargeable profits :** This expression means the total income of an assessee computed under the Income-Tax Act, 1961 for any previous year or years, as the case may be, and adjusted in accordance with the provisions of the First Schedule to the Surtax Act. [Section 2(5)].

3. **Previous year :** Explanation 3 to Rule 2 of the second schedule to the Surtax Act expressly provides that where a company has different previous years in respect of its income profits and gains the computation of capital shall be made with reference to the previous year which commenced first. The concept of previous year is relevant in arriving at the amount of statutory deduction.

The second proviso to section 2(8) of the Surtax Act provides that where the previous year is longer or shorter than the period of twelve months the statutory deduction shall be increased or decreased proportionately. Further, where a company has different previous years for different sources of its income, profits and gains, the aforesaid increase or decrease, as the case may be, shall be calculated with reference to the length of the previous year of the longest duration.

Statutory deduction : This means an amount equal to 15% of the capital of the company as computed in accordance with the provisions of the second schedule to the Companies (profits) Surtax Act or an amount of Rs. 2,00,000 whichever is greater. (Section 2(8).

Authorities : The various authorities appointed under the Income-tax Act, 1961 to administer the law of income-tax will as well administer the law relating to the levy of surtax on companies' profits. The provisions for filing return, making assessment or reassessment, rectification of mistakes, appeals, revision, penalties, offences and prosecutions and double taxation relief under the companies (profits) Surtax Act are generally similar to those under the Income-tax Act though certain modifications have been made in this regard, wherever necessary.

Limitation for completing sur-tax assessment : The M.P. High Court has held in Gwalior Rayon Mills v CIT (1982) 10 Taxman 221 (M.P.) that no period of limitation for completing assessment or for issuing notice under section 6 is prescribed under the Act. Limitation prescribed under Section 8(b) which relates to profit escaping assessment cannot apply to assessment because when a return has been filed but no assessment has been made it could not be said that chargeable profits have escaped assessment.

Computation of chargeable profits : 1. Take the total income of the company as determined under the provisions of the Income-Tax Act 2. From such total income deduct the various items enumerated in (A) below and add the items listed in (B).

(A) 1. *Deductions*; (Rule 1)

- (i) capital gains whether short-term or long-tem ;
- (ii) compensation received for termination of managing agency or other agency chargeable under Section 28 (ii) ;
- (iii) profits and gains from life insurance business ;
- (iv) the amount of balancing charge taxable as profits under Section 41 (2) of the Income-tax Act ;
- (v) interest on tax free securities of the Central Government or a State Government ;
- (vi) a sum equal to 50% of the amount of the donations qualifying for deduction under Section 80G ;
- (vii) dividends (net) from domestic companies ;

(viii) income from royalties (net) received from the Government or local authority or any Indian concern ;

(ix) in the case of a non-resident foreign company, the interest or fees received by it from the Governr ıt or local authority or any Indian concern :

(x) In the case of banking company :

(i) any sum transferred by it during the previous year to its reserve fund under the requirements of section 17 of Banking Regulation Act or

(ii) any sum transferred by it during the previous year to any reserves including secret reserves, provided :

(i) such sums are attributable to income chargeable under Income-Tax Act,

(ii) they have been disallowed while computing income.

(iii) the aggregate of such sums do not exceed the highest of the aggregate of such sums transferred to reserves during any one of the three years prior to the previous years whichever is higher.

Deduction of 'Net' income of the specified types : The Explanation to Rule 1 of the First Schedule provides that in computing the chargeable profits, the amount of income or profits and gains referred to in Rule 1, and listed above, which stands included in the total income will alone be deducted from the chargeable profits.

For example the rules contained in the First Schedule provide for exclusion of dividends from an Indian company and income by way of royalties received from the Government, local authority or an Indian concern from the total income for determining the chargeable profits. It is only the *net* income from dividends, royalties, etc., (after all deductions including deductions under Section 80M and 80MM) that would be deducted from the total income for determining the chargeable profits.

(A) 2 : Other Deductions : From the amount of *total income as adjusted* above, deduct the following under Rule 2 of the First Schedule to the Surtax Act.

(i) The amount of income-tax payable by the company in respect of its total income under the provisions of the Income-tax Act after making allowance for any relief, rebate or deduction in respect of income-tax to which the company may be entitled under that Act or the Annual Finance Act, as the case may be, has to be deducted. However, for arriving at the amount of income-tax the following items should be excluded *i.e.*, the aggregate amount of the tax referable to the following items should be reduced from the total amount of liability towards income tax *viz.* :

(a) The amount of income-tax, if any, payable by the company in respect of any income by way of capital gains, compensation for termination of agency and/or dividends which are included in total income should be excluded from the total tax payable under the Income-tax Act ;

In the case of income by way of dividends the amount of income-tax referred to in this context should be determined after taking into account the deduction allowed under Section 80M of the Income-tax Act. Accordingly, if the whole of the dividends is allowed as a deduction under Section 80M from the gross total income, there would be no question of any tax payable thereon and consequently there would also be no question of any adjustment in the tax payable in arriving at the chargeable profits. If 60% of the dividends is allowed as a deduction under Section 80M the remaining 40% of the dividends income would be regarded as having suffered tax and the tax on that portion of the dividends subjected to tax would be the amount to be reduced from the total tax liability which would be the deduction admissible from the total income to arrive at the chargeable profit.

(b) The additional income-tax which a closely-held company may be required to pay under Section 104 of the Income-tax Act.

(ii) In the case of a company which is liable to income tax both in India *and* in a foreign country on any portion of its income, profits and gains derived from India or outside the tax paid in the foreign country should also be treated as part of the total tax liability deductible from the chargeable profits for purposes of assessment to surtax in India. For obtaining this deduction the assessee must produce evidence of the fact that the tax liability in the foreign country has actually been discharged. The references to tax in the preceding paragraphs would not include any liability for interest, penalty or fine to which the assessee may be subjected for non-compliance with the provisions of the law; but the surcharage on the income-tax would be treated as part of the tax [*Somasundaram (P) Ltd. v. C.I.T. (1979) 116 I.T.R. 620 (Kar.)*]

Deposit of Surcharge with IDBI : Students may note that in cases where option for deposit of surcharge with IDBI is exercised, the full amount of surcharge leviable on income tax may not be deducted for purposes of computing chargeable profits under Rule 2 (i) and only the excess of surcharge payable over the deposit made with IDBI may be deducted. Certain Benches of the ITAT have taken the view that in such cases the amount of deposit made could not be treated as payment of surcharge so as to be deducted for the purposes of arriving at the chargeable profits.

(B) *Addition :*

The net amount of income calculated in accordance with Rules 1 and 2 of the First Schedule to the Surtax Act, mentioned above has to be increased by the amount of any expenditure incurred by the assessee on account of commission, entertainment and advertisement to the extent such expenditure, in the opinion of the Income-tax Officer, is excessive having due regard to the facts

and circumstances of the case. The Income-tax Officer should have obtained the prior approval of the Inspecting Assistant Commissioner to hold that the expenditure in question is excessive in his opinion. It may be noted that under Rule 2 of the First Schedule to the Surtax Act the addition on account of the excessive expenditure by way of commission, entertainment or advertisement has to be made to the chargeable profits, notwithstanding the fact that the expenditure which is considered to be excessive has already been disallowed while computing the assessable profits in making the assessment to income-tax. The Chokshi Committee has recommended the omission of this obviously harsh clause.

Computation of Capital : The Second Schedule to the Surtax Act lays down the rules to be followed for computing the capital of a company for purposes of surtax.

Rule 1 : The capital of a company for surtax purposes will be the aggregate of the following amounts *as on the first day of the previous year* relevant to the assessment year *viz,* (i) the paid up share capital of the company, (ii) development rebate reserve and investment allowance reserve credited under Sections 34(3) and 32A (4) respectively of the Income-tax Act, 1961 (iii) the other reserves of the company as *reduced by* the amounts credited to such reserves as have been allowed as a deduction in computing the income of the company for purposes of income-tax. Where a company has different previous years in respect of its profits, the computation of capital will be made with reference to the previous year which commenced first.

The Explanation to Rule 1 provides that any amount standing to the credit of the accounts of the following nature as on the first day of the previous year relevant to the assessment year should not be regarded as reserve for the purpose of computation of the capital of a company under the sur-tax Act.

(i) Balance in profit and loss account after providing for Dividend, bonus or reserves.

(ii) proposed additions to reserves

(iii) sinking funds

(iv) any item under current liabilities and provisions.

It may be noted that these items have reference to schedule VI in the companies Act viz. the form of balance sheet.

Rule 1A : Adequacy of the provision for taxation & proposed dividends : Under rule 1A, i) where the company has not provided for taxation or proposed dividend or ii) where the Income-tax Officer feels that such provisions fall short of the amount that should have been reasonably provided, the amount of capital of the company shall be reduced by the amount in respect of which no provision has been made or by the amount of shortfall as the case may be.

Measure of reasonable provision for proposed dividend : According to the explanation to rule 1A this means the amount of dividend declared or paid by

the company on or after the first day of the previous year relevant to the assessment year in respect of the previous year immediately preceding the former previous year.

Rule 2 : Suppose a company owns assets giving rise to the following types of income.

(1) Profits and gains of life insurance.

(2) Interest on tax-free securities of the central and state governments.

(3) Dividend income from domestic companies.

It may be noted that as per Rule 1 of First Schedule these incomes are to be deducted while computing chargeable profits. Rule 2 of the second schedule says the capital of the above company should be reduced to the following extent.

Cost of the above-mentioned assets as on the first day of the previous year relevant to the assessment year—(outstanding borrowals as on the first day of the previous year and any fund, surplus or other reserve not taken into account while computing the above capital).

On the question whether the reduction in the company's capital contemplated by Rule 2 of the Second Schedule to the Surtax Act should be effected even if the relevant item of income exempt from surtax is not derived by the company in a particular year, judicial opinion is divided. The Madras High Court has taken the view in *Addl. C.I.T. v. Motor and General Insurance Co. Ltd. 1979 113 I.T.R. 345* that only in those years in which the exempt income is derived by the company and the exemption from surtax in respect thereof is actually obtained for purposes of determining the chargeable profits the question of reduction of the company's capital to the extent of the cost of the assets giving rise to the exempted income would arise. For instance, if a company has invested Rs. 10 lakhs in shares and during the year 1978 it had not derived any income by way of dividends on those shares, for the assessment year 1979-80 the capital of a company computed under Rule 1 of the Second Schedule should not be reduced by Rs. 10 lakhs because, no dividend having been derived, no exemption under Rule 1 (viii) of the first Schedule to the Surtax Act could be regarded as having been given to the assessee. However, in *C.I.T. vs. United Breweries Ltd. (1978) 114, I.T.R. 901* the Karnataka High Court has taken the view that whether or not the exempt income is derived in a particular year and the exemption from surtax is obtained, the company will have to reduce its capital by the cost of investment in the assets which might have given rise to the benefit of exemption if the income had been derived.

Revaluation of book asset : Explanation 1 provides that a paid-up share capital or reserve brought into existence by creating or increasing (by revaluation or otherwise) any book asset is not capital for computation of capital of a company.

... on shares : *Explanation 2 provides that any premium received in cash by the company on shares issued, standing to the credit of the share premium account shall be regarded as forming part of its paid up share capital.*

Rule 3 : *After the first day of the previous year relevant to the* assessment year, there may be an increase or decrease in the paid-up share capital of a company. Rule 3 provides *that in such a situation*, the capital as computed as per *the* above rules, should be increased or decreased, as the case may be, by a sum which bears to that amount the same proportion as the number of days of the previous year during which the increase or the reduction remained effective bears to the total number of days in that previous year.

Rule 4 : It is possible that a part of the income, profits and gains of a company might not have been included while computing its income under the income-tax Act. In that situation rule 4 provides that the capital computed as per the rules above should be reduced by an amount which bears to the capital so arrived the same proportion as the amount of the aforesiad income, profits and gains bears to the total amount of its income profits and gains.

Thus the capital has to be further reduced to the extent of the proportion of the income exempt from income-tax by virtue of the exclusion thereof from the total income under Sections 10 to 13A of the Income-tax Act; but if the exemption is the result of deduction in respect thereof being granted under Sections 80A to 80VV of the Income-tax Act the case should not be treated as one of income which is totally not includible in the assessable income and consequently, the question of applying Rule 4 would not arise. This has been made clear by the decisions in *Stump Scheule & Somappa Pvt. Ltd. v. I.T.O. 102 I.T.R. 320 (Kar) Addl C.I.T. vs., Bimeial Bearings Ltd. (1977) 110 I.T.R. 131 (Mad), C.I.T. v. Ballarpur Industries Ltd. (1979) 116 I.T.R. 128 (Bom.) C.I.T. Century Spinning & Manufacturing Co. Ltd. 111 I.T.R. 6*

The Karnataka High Court held in *International Investment (P) Ltd. v. C.I.T, (1982) 133 I.T.R. 285* that tax credits under Section 280ZB have no taint of income and cannot be taken into account for purposes of diminishing capital base under Rule—4.

Income not includible in the total income referred to in Rule 4 mentioned above would not also include any income which is exempt from surtax under Rule 1 of the First Schedule to the Surtax Act *e. g.* capital gains, dividends, balancing charge, *etc*.

Reserve : The question as to what constitutes a reserve and whether, in a particular case, the amount shown in the balance sheet of a company represents a 'reserve' or "provision" will have to be determined in each case having regard to the facts and circumstances of the case. If an amount of reserve is wrongly described as provision it would still be includible in the computation of the capital : likewise, the provision wrongly described in the accounts as a reserve would not entitle the assessee and the assessing authorities to include the same from the company's capital. As the Calcutta High Court observed in *Braith-*

waite & Co India Ltd. v. C.I.T. (1968 111 I.T.R. 825) "the question whether a particular item constitutes 'reserve' or a 'provision' must be determined, taking into account the principles of accounting, company law and tax laws; in computing the capital of a company for purpose of surtax the true nature and character of the sum designated as 'reserve' is to be determined with reference to the provision made on account of liabilities which have already arisen and which cannot be properly termed as 'reserve'. The accounts of a company may be made up for a year up to a particular date at a later point of time. A company can similarly finalise its appropriations for various purposes, including reserves and provisions, at a later date with retrospective effect. A company can take advantage of the retrospective effect of its determination of appropriations; but it cannot, then, contend that by being retrospective the nature of the appropriation will change."

The Supreme Court recently held in the case of *Vazir Sultan Tobacco Co. Ltd and others v. CIT (1981) 7 Taxman 28 (SC)* that in the absence of a specific definition of the terms "reserves" and "provisions", the meanings attached to these two words in the provisions of Companies Act dealing with preparation of balance sheet and profit and loss account would govern their construction for the porposes of the taxing enactments also under clause 7(1)(a) and (b) of part III of Schedule VI of the Companies Act. The expression "provision" shall subject to sub-clause (2) mean any amount written off or retained by way of providing for depreciation, renewals, or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy and the expression "reserve" shall not subject to as aforesaid include any amount written off or retained by way of providing for depreciation, renewals or diminution in valuation of assets or retained by way of providing for any known liability. The expression "known liability" in the context of surtax should be taken to refer only to a liability existing on the relevant date and not a future liability. So long as the assessee has not estimated the current liability and set it apart or charged it to the current year and claimed a deduction therefor for purposes of income-tax it cannot be said that provision has been made by it towards an existing liability *CIT v. Orissa Cement Ltd. [1980] 124 ITR 251 (Delhi).*

Sub-clause (2) of clause 7 of the above schedule provides that where any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets not being an amount written off in relation to fixed assets before the commencement of this Act, or any amount retained by way of providing for any known liability, is in excess of the amount which in the opinion of the Directors is reasonably necessary for this purpose, the excess shall be treated for purpose of the Schedule VI as a 'reserve' and not as 'provision'. The effect of reading the two definitions together is that if any retention or appropriation of a sum falls within the definition of 'provision', it can never be a reserve but it does not follow that if the retention or appropriation is not a provision, it is automatically a reserve. The question will have to be decided having regard to true nature and character of the sum so

retained or appropriated depending on several factors including the intention with which and the purpose for which such retention of the depreciation has been made because the substance of the r ter is to be regarded.

One of the important considerations which must enter into the determination of the question whether a particular amount constituted a *'reserve'* or a 'provision' is whether the amount is set apart for a contingency which is known to exist at the date of the balance sheet. Unless the relevant amount could be said to have been set apart for contingencies which were known to exist on the date of the balance sheet the said amount could not be termed as 'provision' *[CIT v. Hindustan Lever Limited (1981) 7 Taxman 112 Bombay].*

The decision of the Supreme Court in *C.I.T. vs., Mysore Electrical Industry Limited (1971) 80 I.T.R., 566* has laid down the principle that any addition to the reserve which is sought to be made by the Board of Directors of the company out of the profits of any particular year would, immediately on being approved by the shareholders of the company at the Annual General Meeting, shed their character as proposed additions to the reserve and would become a part of the reserves of the company *with effect from the first day of the immediately following accounting year.* The additions to the reserve cannot be treated as taking effect only on the date on which the meeting of the Board of Directors and/or the meeting of the shareholders takes place nor would the increase in the reserve be regarded as being effective from the date on which the entries in the books of accounts are made by the company in pursuance of the resolutions passed by the Board of Directors and the shareholders at their meetings. Thus any appropriation of profits to the reserve accounts should, even though made after the first day of the immediately following accounting year, relate back to the first day of the accounting year in which the appropriation is sought to be made and must consequently be regarded as legally effective for all purposes as a reserve from the date of commencement of the accounting year. But a mass of unappropriated profits standing to the credit of the profit and loss account or profit and loss appropriation account, disclosed in the liabilities side of the balance sheet of a company, would not constitute a reserve. Therefore, it is essential that "some one possessed of the requisite authority must make a declaration or give some indication that the manner of the disposal of or the destination of the amount in question is that it is being carried to reserve" as was held by the Supreme Court in *C.I.T. v. Century Spinning and Manufacturing Co. Ltd., (1953) 24 I.T.R. 499.* The appropriation should be specific, clear and unambiguous so that the same amount does not get appropriated more than once nor is the same amount appropriated to different reserves in different years.

The reserve referred to in this context need not necessarily be created out of profits assessable to income-tax and/or surtax. For the purpose of inclusion in the computation of the capital of a company, it is immaterial whether the reserve is created in compliance with a statutory provision or voluntarily by the Board of Directors of the company. However, reserves created by statutory

financial corporations engaged in providing long term finance for industrial and agricultural development would *not*, to the extent of the amount of its reserves admissible as a deduction under Section 36 (1) (iii) of the Income-tax Act, be treated as part of the reserve of a company for surtax purposes, although such a reserve is also nothing but an appropriation of profits.

There are a number of judicial rulings involving the question whether a particular item constitutes reserve or provision and how the same should be dealt with for the purposes of sur-tax. Some of the important rulings and the principles emerging therefrom are given hereunder :

1. *Provision for gratuity :* As regards the retirement gratuity a company can work out on actuarial valuation basis an estimated liability (i.e.) discounted percentage value of the liability under the scheme on a scientific base) and make a provision for such a liability not all at once but spread over a number of years. It is clear that if by adopting such a scientific method any appropriation is made such an appropriation will constitute a provision as representing fairly an accurately known and existing liability for the year in question. If however an *ad hoc* sum is appropriated without resorting to any scientific base, such an appropriation would also be a provision intended to meet a known liability, though a contingent one, for the expression liability occurring in clause 7 (1) (a) of Part III of Schedule VI to the Companies Act includes any expenditure contracted for and arising under a contingency liability. However, if the sum so appropriated is shown to be in excess of the sum required to meet an estimated liability (i.e. discounted percentage value on a scientific base) it is only the excess that will have to be regarded as a reserve under clause 7 (2) of Part III of Schedule VI to the Companies Act.

It is for a company to clarify by placing material on record as to whether an appropriation of the amount was based on any actuarial valuation or whether it was an appropriation of an *ad hoc* amount. This aspect will have a vital bearing on the question whether the appropriation would be treated as a provision or a reserve, [vide Supreme Court decision in *Vazir Sultan Tobacco Co. Ltd. and others v. C.I.T. (1981) 7 Taxman 28* (S.)].

Where the assessee company had shown in its balance sheet identical amounts for three consecutive assessment years as gratuity reserve it was held that the fact that an identical amount was carried forward in all three consecutive assessment years would indicate that this was just setting apart in an *ad hoc* manner and without any correlation with the actual or estimated liability for payment of gratuity and therefore the impugned sum would constitute reserve *CIT v. Asian Paints India P. Ltd. (1983) 8 Taxman 208 (Bom.).*

2. *Special Reserve for Tax* created by a contractor company on the basis of estimated profits relating to incomplete part of the contracts constitute Reserves—*CIT v. Braithwaite Born & Jessop Contruction Co. Ltd. (1978) 113 ITR 577 (Cal.)*

3. *Dividends :*

(a) *Forfeited dividends :* As the ne has not been set apart ex facie for any unexpected loss or continge. claim it would be treated as reserves. *Orient Paper Mills Ltd. v. CIT 1978 (1978) 113 ITR 550.*

(b) *Proposed dividend :* 1. Until the dividend is declared no debt is created. However, from a common sense and broad point of view it cannot be considered as a sum available for use in the future by the assessee company in its business. Therefore proposed dividend has to be excluded from computing the capital base for determination of the statutory deduction. *Sankey Electrical Stampings Ltd. v. CIT (1981) 7 Taxman III (Cal).*

2. The amount set apart towards "proposed dividend" is a provision and hence, is not includible in capital computation *CIT v. Gokak Mills Ltd. (1982) 155 ITR 758 Bom.*

3. As soon as an amount is set apart for proposed dividend, it gets separated from the general mass of profits by the board of director's resolution. This segregation is destructive of the proposed amount being treated as 'reserve' as the same could not be subsequently available to the company for being used in its business. The fact that for such a proposal the directors will get the approval of the shareholders only subsequently will not make any difference. *CIT v. Glaxo Laboratories (India) Ltd. (1932) 8 Taxman 203 (Bom).*

(c) *Dividend Equalisation Reserve :* Only the balance left after distribution of dividend would be treated as accretion of 'reserve'—CIT v. Modi Industries Ltd. (1978) CTR (ALL)440.

Any amount required for incurring any expenditure or making any disbursement in current year coming out of past savings, such as payment of dividend or making any provision for dividend in form of such reserve is excludible from capital. *Vazir Sultan Tobacco Co. Ltd. vs CIT 132 559 (Supreme Court).*

On the other hand several courts have held that the amount appropriated to the dividend equalisation reserve is not set apart for meeting contingent liability and hence could constitute reserve.

CIT v. Bharat Bijlee Ltd. (1977) 107 ITR 30 (Bombay).

CIT v. Golden Tobacco Co. Ltd. 108 ITR 453.

CIT v. Thirumangal Ltd (1977) 108 ITR 236.

CIT v. Standard Pharmaceuticals Ltd. (1977) 119 ITR (101).

However if the company could prove that the amount appropriated to the dividend equalisation reserve is not set apart for meeting any contingent liability, it could be treated as reserves. (C.I.T. v Century Spinning and Mfg. Co. Ltd. (1977) 109 ITR 209 Bombay and other case).

It is also possible to treat that portion which represents the excess over the liability to meet the payment of dividends declared by the company as part of its reserve includible in the computation of capital.

The question whether the concerned amount in fact constitutes reserves or not will have to be decided having regard to the true nature and character of the sum so appropriated depending on the surrounding circumstances particularly the intention with which and the purpose for which such appropriation had been made.

4. *Reserve for Bad & Doubtful Debts.* (a) Where the reserves are created without any reference to outstanding sundry debtors in the balance sheet and in the absence of any unexpected or unknown existing liability, such reserve should be treated as reserve for the purpose of computation of capital—*CIT v. M/s. Jyoti Ltd. (1977) 112 ITR 973.*

(b) *Ad hoc* transfer to bad and doubtful reserve account and retirement gratuity reserve qualify as reserves to be included in the computation of capital.

(c) However, amounts representing specific doubtful debts, duly taken into account by the assessee cannot be treated as reserves for the purpose of capital computation, *(Lucas India Service Ltd. v CIT (1981) 6 Taxman 276 (Mad).*

(d) Where the "provision" made for bad and doubtful debts was far in excess of the bad and doubtful debts which had been provided for in the balance sheet from year to year, it was held that such excess provision constituted 'reserve' includible in the computation of the capital of the assessee *CIT v. Karam Chand Thapar & Bros. (1981) 5 Taxman 318 (Cal).*

5. *Taxation Contingency Reserve :* In cases where following prudent financial policy, the estimated tax savings for claiming the initial and double depreciation have been set aside and there is no known liability for this account, such reserves are to be considered as reserves for capital purposes *[CIT v. Hindustan Lever Ltd. (1981) 7 Taxman 112 (Bom).]*

6. *Provision for Bonus :* When such provision is created, where no financial liability has arisen, it should be treated as 'reserve'—*CIT v Swadeshi Cotton & Flour Mills Pvt. Ltd. (1964) 53 ITR 134.*

Provision for bonus for the purpose of meeting the known present liability according to the bonus formula in terms of agreement in force between the employer and the employee would not constitute "reserve" and is not includible in capital employed *Mettur Industries Ltd. v. CIT (1978) 114 ITR 44 9 (Mad).*

Where the assessee-company had set apart certain amounts, being staff benefit reserve, for implementation of various benefit schemes and there was no obligation on the part of the assessee to spend the said moneys for the benefit of any particular employee it was held that the said staff benefit reserve was in the nature of reserve C.I.T. Minerals & Metals Trading Company India (1981) 25 CTR (Del) 228.

7. *Subsidy received from the Government :* In a case where subsidy was received from the Government and was shown as reserve without any known risk of returning it to the Government, it was held that such subsidy should be

treated as reserve for the purposes of computation of capital—*Addl CIT v. Indian Telephone Industries (1979) 118 ITR 297.* The Court held in this case that a reserve need not necessarily be created out of profits and could come out of other surplus also.

8. *Excess of Depreciation :* Excess depreciation over the amount allowed by the Income-tax Authorities which is not set apart for future use cannot be treated as reserve. Initial depreciation reserve where such depreciation had been allowed as a deduction in the computation of the income—not to be treated as a 'reserve' *Madhya Pradesh Sugar Mills Co. Ltd. v CIT (1979) 120 ITR 348.*

Where the assessee claimed that the difference between depreciation actually granted in the income-tax assessments and that provided in the books should be included in computing its capital, but it did not create any specific reserve for the said difference, it was held that the impugned reserve could not be taken note of as reserve for capital computation. *English Electric Co. of India Ltd. v. CIT (1981) 132 ITR 25 (Mad).*

9. *Shortfall in Depreciation provisions :* If the assessee company does not provide in its books of account adequate amount of depreciation which is deductible under the Income-tax Act and transfers the higher resultant profits to the general reserve the amount of shortall in the depreciation provision would have to be deducted from the capital base for the purpose of surtax. *CIT v. Zenith Steel Pvt. Ltd. 112 ITR 215.*

10. *Reserve for pension :* Where the reserve has not been drawn since its inception and was ultimately transferred to the general reserve account and was also used for declaring dividends it was held to be in the nature of reserve for the purposes of computation of capital—*Addl. CIT v. Cragmore Land and Produce C. Ltd. (1979) 116 ITR 889 (Mad).*

11. *Issue of bonus shares :* Where during the relevant previous year by capitalising a part of the reserve which existed as on the first day of the accounting period, bonus shares are issued, the advantage of Rule 3 of Schedule II to the Companies (Profits) Surtax Act, cannot be taken into account because there is no fresh issue of capital, but merely bonus shares are issued by capitalising a part of the reserve. *CIT, v. Century Spinning and Manufacturing Co. Ltd. 111 ITR 6* The Delhi High Court also held recently in *Addl. CIT v. Food Specialities Ltd. (1981) 129 ITR 731* that the capital as computed in accordance with Rule 1 of Schedule II of the Companies (Profits) Surtax Act, could not be increased by the increase in the paid up capital effected by capitalisation of the general reserve existing as on the first day of the accounting period. The Court pointed out that the assessee could not claim any stepping up of the capital computation under Rule 3 in respect of the amount which was already included in the capital computation as on the first day of the previous year. It is only the extent of surplus or excess over the capital as computed at the beginning of the accounting period that the assessee gets the relief as envisagedin R ule 3.

12. *Surplus in the balance sheet but not earmarked :* Where the amounts shown as surplus in the assessee's balance sheet were not earmarked for any specific contingency or purpose but were intended to be treated as part of the general reserve, it was held that the impugned amounts constituted "reserve" for the purpose of inclusion in the assessee-company's capital base. *Dunlop India Ltd. v. CIT (1982) 10 Taxman 220 (Cal).*

13. **Capital Redemption reserve :** The Calcutta High Court, applying the Supreme Courts' decision in Vazir Sultan Tobacco Co. Ltd. v C.I.T. (1981) 132 ITR 559 (SC), recently held in C.I.T. v. Placid Limited [1984] 150 ITR 74 that 'Capital redemption reserve' is a *reserve* and not a provision within the meaning of rule 1 of Schedule II to the Companies (Profits) Surtax Act, 1964, as also the Companies Act 1956, and is to be included in the computation of Capital for purposes of surtax. The Court followed its earlier decision in Duncan Bros., and Co. Ltd. v. CIT (1978) 111 ITR 885 (Cal) and Duncan Bros and Co. Ltd. v. CIT (1981) 128 ITR 302 (Cal). The Court pointed out that a perusal of Section 80 of the Companies Act, 1956 shows that the redemption of redeemable preference shares is a right conferred on the Company and not on the holders of such shares who cannot call upon the company for redemption. Even when the company decides to redeem such shares it is not bound to fall back upon the reserve created for the purpose of such redemption. It is open to the company to issue new shares in lieu of the redeemed shares. A company can utilise its capital redemption reserve for the purpose of issuing fresh paid up shares to its existing shareholders. Therefore, such a reserve, not earmarked for a known liability, does not fall within the positive definition of a 'provision' in Clause 7 of Part III of Schedule VI to the Companies Act, 1956.

The Court pointed out that the Capital redemption reserve is an amount earmarked or set apart to be utilised in future for a specific purpose or on a specific occasion, if necessary, and as such, it fulfils the tests of a reserve. The capital redemption reserve has been particularly included under the heading reserve in the form of balance sheet as provided for in Schedule VI of the Companies Act, 1956.

In this view of tne matter, the Court held that the item 'Capital redemption reserve' is a reserve and not a provision within the meaning of rule 1 of Schedule II to the Companies (Profits) Surtax Act, 1964 as also the Companies Act, 1956 and is to be included in the computation of Capital for purposes of surtax. The earlier decision of the Karnataka High Court in C.I.T. v. Bharat Fritz Werner (P) Ltd. (1979) 118 ITR 25 also expressed the same view.

14. Excess development rebate reserve/investment allowance reserve is part of capital—*Ugar Sugar Works Ltd. v. CIT (1980) 4 Taxman 118 (Bom).*

15. Retained earnings and the unremitted foreign income of the assessee a company incorporated in the US, is in the nature of general reserve and includible in *Capital Hecket Engg. Co. v. CIT (1979) 120 ITR 417 (Pat).*

16. *Secret reserves :* Where the assessee banking company held a reserve in the form of premium and discount account and this reserve was neither reflect-

ed in the balance sheet nor was its creation expressly authorised by the assessee's board of directors it was held that in view of the provisions of the Banking Regulation Act, 1949 and the Companies Act, 1956 the impugned secret reserves should be deemed to have been created nder the authority of the Board of Directors and accordingly, the impugned reserve qualified for inclusion in the assessee bank's capital base—*CIT v. Bank of India (1981) 7 Taxman 258 (Bom).*

17. *Additional depreciation reserve on revaluation :* Where on revaluation of its assets, the assessee company had provided additional depreciation reserve to meet replacement cost for machinery and plant becoming too old and being rendered useless, it was held that the impugned sum should be treated as reserve for the purpose of computation of capital of the assessee-company—*Sankey Electrical Stampings Ltd. v. CIT (1981) 7 Taxman 111 (Cal).*

18. *Goodwill* : Where the goodwill of the assessee company was written off from the balance sheet and transferred to the profit and loss account and no evidence was available that written off goodwill amount was available for the future use of the assessee, it was held that the goodwill amount was not a reserve includible in the computation of capital—*Shaw Wallace & Co. Ltd. v. CIT (1982) 11 Taxman 230 (Cal).*

Advance Payment of Surtax

Sections 7A to 7D of the Surtax Act deal with this matter.

A company which is liable to pay surtax in any year has to deposit the same in three equal instalments. There is no provision enabling the Income-tax Officer to issue a notice calling upon the Company to pay advance surtax.

The three instalments for advance tax are the same as under the Income-tax Act viz 15th June, 15th Sept. and 15th Dec. when 75% or more of the chargeable amount derived by a Company relates to its previous year ending on or before 31st December. In other cases, the instalments are payable on 15th Sept., 15th Dec. and 15th March.

If no regular assessment of a company under the Surtax Act for any year has been completed, the Company can file an estimate of current chargeable amount before the last instalment is due and pay the surtax in advance on the date on which last instalment is due.

When the Company has been assessed to surtax in the past, the Company can file a "statement" before the date on which the first instalment is due and pay the advance surtax on the basis of this statement in 3 instalments. The statement referred to above can be filed on the basis of the last assessed figure of chargeable amount. If a provisional assessment has been made under Section 7 for any later year on a figure higher than the last assessed chargeable profit, the statement will have to be filed on the basis of the higher figure.

If the Company finds that its current chargeable amount is likely to be less than the above figures, it can file an estimate of its chargeable amounts before the date on which first instalment is due. If the Company has filed any state-

ment or estimate for advance surtax it can send a revised estimate before the second or third instalment is due.

Before the last instalment is due, the company will have to estimate its surtax liability afresh and file an upward estimate if it finds that the advance surtax payable on its current chargeable amount exceeds the advance tax paid on the basis of earlier statement/estimate by more than 20.

If the last date for furnishing advance tax estimate has been extended by the C.I.T. under Section 290A (4) or 212 (3A) of the I.T. Act, the Company can file the advance surtax estimate before such extended date.

Interest on Advance Tax

If the advance surtax paid by a company in any financial year is more than the surtax payable on regular assessment, the Company will be entitled to get simple interest at 12% P.A. from the 1st day of April next following the end of the financial year to the date of regular assessment under Section 7B.

If the advance surtax paid by the company in any financial year is less than 83-1/3% of the assessed surtax, the Company will be liable to pay simple interest at 12% P.A. from the 1st day of April next following the end of the financial year to the date of regular assessment under Section 7 C. Similarly interest is also payable if the company has not filed the statement/estimate and not paid advanced surtax as required under Section 7A. The Income-tax Officer can reduce or waive this interest under such circumstances as may be prescribed. When demand for surtax is reduced in appellate or other proceedings, the Income-tax Officer has to correspondingly reduce the demand for interest.

Penalty

New Section 9H provides for levy of penalty when the company has failed to file the statement/estimate under Section 7A or has filed false statement/estimate of advance surtax. The provisions of this section are on the same lines as Section 273 of the I.T. Act. The penalty is leviable if the advance surtax paid is less than 83-1/3% of the assessed surtax. The minimum penalty is 10% and the maximum 150% of the shortfall (difference between 83-1/3% of assessed surtax and the surtax paid in advance).

Rates of Surtax : The rates of surtax are prescribed under the Third Schedule to the Surtax Act. The surtax payable by a company should, in every case, be computed *on the chargeable amount e.g.*, the excess of chargeable profits over the statutory deduction at the following rates :

(i) on so much of the *chargeable amount* as is not in excess of five per cent of the company's capital—25 per cent.

(ii) on the balance of the chargeable amount—40 per cent.

In cases where the assessee is an Indian company or any other company which has made the prescribed arrangements for the declaration and payment of dividends within India, i.e., a domestic company, the total amount of income-

... payable by the company on its total come after taking into account any relief, rebate or deduction to which the c pany is entitled and the amount of surtax computed at the rates mentioned ab e should be aggregated to ascertain whether such aggregate amount exceeds 70% *of the company's total income* for the relevant assessment year determined under the Income-tax Act. If the aggregate of the income-tax and surtax as computed exceeds 70% of its total income in the case of a domestic company in which the public are substantially interested the excess over 70% should be ignored if the company is one whose paid-up share capital (subscribed and paid for in cash) as on the *last day of the previous year is not less than* 25% of the amount of the Company's capital. If, however, the assessee is not a domestic company or, being a domestic company; it is not a company in which the public are substantially interested or a wholly owned subsidiary of such a company the question of application of the ceiling of 70% would not arise. Further, even in the case of a widely held domestic company if the paid-up share capital is less than 25% of the company's capital, as on the last day of the previous year, the company would not be entitled to the ceiling in the tax payable by it. If in any year the company's chargeable profits as determined under the First Schedule to the Surtax Act is less than the amount of statutory deduction and consequently there is a *deficiency*, the amount of such deficiency cannot be carried forward by the company to be set off against its chargeable profits for the subsequent years for the purposes of surtax.

Illustration :

The following are the particulars of income for the year ended 30.9.83 and the balance sheet as at 30.9.83 of ABC Ltd. a widely held (industrial) company. From these and the other details given below compute the company's Surtax liability for the assessment year 1984-85.

Particulars of Gross Total Income for the year ended 30.9.83

		Rs.
1.	Agricultural income	3,00,000
2.	Interest on 3% Tax-free Government securities	5,000
3.	Income from house property (as per the IT provisions)	7,000
4.	Business Profit before tax and necessary appropriations	1,86,00,000
5.	Compensation on Termination of sole selling agency	1,80,000
6.	Profits u/s 41 (2) of IT Act	2,00,000
7.	Royalty from an Indian company under Technical know-how agreement not yet approved by the Central Govt.	2,70,000

		Rs.
8.	Dividends from Indian companies (Gross)	60,000
9.	Short-term capital gains on sale of motor cars	50,000
10.	Long-term capital gains on sale of Plant and Machinery	6,30,000
	Total income	2,03,02,000

Items debited to P&L account

		Rs.
(1)	Interest on 6% convertible debentures	4,50,000
(2)	Interest on long-term secured loans @ 12%	3,60,000
(3)	Disallowances with regard to remuneration to Managing Director and Sales Manager	60,000
(4)	Donation to Jawaharlal Nehru Memorial Fund	2,40,000

Balance Sheet as at 30.9.83

(Rs. in lakhs)

Liabilities	30.9.82	30.9.83	*Assets*	30.9.82	30.9.83
Share capital	150	200	*FIXED Assets*		
Reserves & Surplus	187	192	Gross Block	583	639
			Less Depreciation	251	283
			Net Block	332	356
Long Term Loans					
6% Convertible Debentures	75	75	*Investments*		
12% Secured Loans from			3% Tax Free Govt.		
IFCI (Repayable in 10 years)	9	63	Securities	1	1
			Fully paid Equity		
			Shares of Indian		
			companies	1	1
Current Liabilities &			*Current Assets, Loans &*		
Provisions			*Advances*		
Creditors	150	206	Inventories (at cost)	352	417
Short-term borrowings			Sundry debtors	263	340
from banks & others	367	315	Cash and bank	10	7
Provision for bonus	4	3	Loans and advances	61	67
,, ,, Gratuity	25	30			
,, ,, Taxation	43	105			
	1020	1,189		1020	1189

1. Agricultural land (at cost) Rs. 1 lakh included in Gross Block of Fixed Assets.

2. 50,000 Bonus shares of Rs. 100 each fully paid-up issued on 1.4.83 by capitalisation of general reserve.

3. Share premium received in cash.

4. Investment allowance reserve created all along @ 100%

5. Provision for doubtful debts made on an *ad hoc* basis.

6. Provision for bonus made as per Payment of Bonus Act 1965.

7. Provision for gratuity made on an acturial basis and assumed to be in conformity with conditions laid down in Section 40A (7).

8. All other reserves created by appropriations from net profits.

9 Additional secured loans of Rs. 44 lakhs obtained from IFCI on 1.7.83 repayable during a period of 10 years at 12% per annum.

10. No dividend has been recommended by the board for 1982-83.

11. The details of Reserves and Surplus appearing in the balance sheet are as follows :

		30.9.82	30.9.83
1.	Share Premium account	10	10
2.	Exchange fluctuation reserve	20	22
3.	Investment allowance reserve	9	14
4.	Plant Replacement Reserve	10	13
5.	Repairs & Renewals Reserve	6	9
6.	Dividend Equalisation Reserve	10	10
7.	General Reserve	79	70
8.	Deferred Taxation Reserve	27	27
9.	Debenture Redemption Reserve	14	16
10.	P&L Account Surplus	2	1
		187	192

ABC Ltd.

Domestic industrial company

Asst. Year 1984 1985

1. *Previous year 30.9.83*

Computation of Total Income

1. Agricultural Income-exempt under/section 10(1)		
2. Interest on Tax free Government Securities (includible u/s 66 in Total income subject to Rebate u/s 86A)		5,000
3. Income from house property		7,000
4. *Income from profits and gains of business :*		
	Rs.	
Net profit	1,86,00,000	
Compensation	1,80,000	
Profits u/s 41 (2)	2,00,000	
	1,89,80,000	
Add : Disallowances	60,000	
		1,90,40,000
5. Short-Term Capital Gains		50,000
6. Long-term Capital Gains		6,30,000
7. *Income from other sources :*		
Dividends (Gross)	60,000	
Royalty	2,70,000	3,30,000
Gross Total income		2,00,62,000
Less Deductions		
80G—50% of Rs. 2,40,000	1,20,000	
80M—60% of Rs. 60,000	36,000	1,56,000
Total income :		1,99,06,000

2. *Income-Tax liability*

Taxable income	1,99,06,000
Less : Long Term Capital Gains	6,30,000
	1,92,76,000
I. T. @ 55%	1,06,01,800
SC @ 5%	5,30,090
	1,09,31,890

I.T. @ 40% on 6,30,000	2,52,000
	1,11,83,890
Less : Rebate u/s 86A @ 27½ on Rs. 5,000	1,375
Gross Income Tax payable	1,11,82,515

Note : Tax deducted at source is not to be taken into account in computation of gross I.T. payable.

3. *Computation of chargeable profits under First Schedule :*

	Rs.		Rs.
Total taxable income			1,99,06,000
Less : As Per Rule 1 :			
Interest on Tax free Govt. Securities	5,000		
Compensation u/s 28 (ii)	1,80,000		
Profit u/s 41 (2)	2,00,000		
Capital gains :			
Short Term	50,000		
Long Term	6,30,000		
Donation to Jawaharlal Nehru Memorial Fund @ 50%	1,20,000		
Dividends (net)	24,000		
Royalty	2,70,000		14,79,000
			1,84,27,000
Less : Per Rule 2			
(Total I.T.)			
Payable (before rebate)	1,11,83,890		
Less : Rebate u/s 86A	1,375		
I. Tax & SC at 57.75% on			
Compensation	1,03,950		
Net dividends	13,860		
Short term capital gains	28,875		
40% I.T. on Long-Term Capital Gains	2,52,000		
		4,00,060	
			1,07,83,830
Chargeable profits			76,43,170

4. ***Computation of capital employed under Second Schedule :***

	Rs.
Paid-up Share Capital	1,50,00,000
Add : Share premium received in cash	10,00,000
Exchange Fluctuation Reserve	20,00,000
Investment Allowance Reserve	9,00,000
Plant Replacement Reserve	10,00,000
General Reserve	70,00,000
Deferred Taxation Reserve	27,00,000
	2,96,00,000
Rule 3. Proportionate increase of paid-up share capital by issue of bonus shares (See Note 1)	Nil
	2,96,00,000
Rule 4. Deduct : Proportionate Capital in respect of agricultural income	4,37,395
	2,91,62,605

$$\frac{2,96,00,000 \times 3,00,000}{2,30,02,000}$$

5. *Computation of Surtax under Third Schedule :*

Chargeable profits	76,43,170
Less : Statutory deduction u/s 2 (18) @ 15% of 2,91,62,605	43,74,391
Net chargeable profits	32,68,779

6. *Surtax payable for Asst. year 1984-85 :*

Upto 5% of capital is Rs. 14,58,130	3,64,533
Balance of net chargeable profits (32,68,779—14,58,130) =18,10,649 @ 40%	7,24,260
Surtax payable	10,88,792

7. *Limit :* Total income-tax liability	1,11,82,5[illegible]
Total surtax liability	10,88,792
	1,22,71,307

70% of total income of 1,99,06,000=1,39,34,200

Since the total tax liability is not in excess of 70% of total income, the concession given by Third Schedule is not applicable.

Note : **If during the course of the previous year a part of the amount standing to the credit of the general reserves is capitalised by issue of fully paid-up bonus shares it cannot be said that capital of the company computed in accordance with Rule 1 of the Second Schedule is increased by any amount by such issue of bonus shares. What happens in such a case is that a part of the sum standing to the credit of one of the sub-items to be included in the computation of capital is during the previous year transferred to another item to be included in the computation of capital under Rule 1. Therefore, when bonus shares are issued as fully paid-up shares by capitalisation of a part of the amount standing to the credit of the general reserves, the capital, as computed in the manner provided by Rule 1 of the second schedule is not increased in any manner whatsoever.**

Century Spinning Mfg. Co. Ltd. (1978) 111 ITR 6 (Bombay)

Food Specialities Ltd. (1981) 129 ITR 731 (Delhi)

Sundaram Clayton Ltd. (1982) 31 CTR 3 (Madras)

It may be noted that if an increase in share capital had been effected by the issue of shares for cash after the first day of the previous year then a proportionate increase in the capital employed is to be given.

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